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VIA HAND DELIVERY

The Honorable Anne K Quinlan, Acting Secretary
Surface Transportation Board
395 E Street, S.W
Washington, DC 20423-0001

Re· STB Finance Docket No 35081
Canadian Pacific Railway Company, et al – Control – Dakota, Minnesota & Eastern Railroad Corp , et al

Dear Secretary Quinlan

The Kansas City Southern Railway Company ("KCSR") hereby files its Rebuttal in Support of Request for Conditions ("Rebuttal") in the above-captioned matter Enclosed, please find an original and eleven copies of each version of KCSR's Rebuttal – a Highly Confidential Version and a Public Version. In the Highly Confidential version, the material that is within the brackets is redacted in the Public Version Note that the Rebuttal also contains color exhibits *

Please date stamp the extra copy of each version of the Rebuttal for return to our offices Also enclosed are three compact disks containing electronic versions of this filing. If there are any questions concerning this filing, please contact me by telephone at (202) 663-7823 or by e-mail at wmullins@bakerandmiller com

Sincerely,

William A Mullins

Enclosures

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BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET. NO. 35081

CANADIAN PACIFIC RAILWAY COMPANY, ET AL.

– CONTROL –

DAKOTA, MINNESOTA & EASTERN RAILROAD CORP., ET AL.

REBUTTAL OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY IN SUPPORT OF ITS REQUEST FOR CONDITIONS

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Attorneys for The Kansas City Southern
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Dated: May 19, 2008

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IN SUPPORT OF ITS REQUEST FOR CONDITIONS**

INTRODUCTION AND BRIEF SUMMARY OF ARGUMENT

In accordance with the procedural schedule set forth in Decision No 4 in the above-captioned proceeding, The Kansas City Southern Railway Company ("KCSR") hereby submits this Rebuttal In Support Of Its Request For Conditions ("Rebuttal") In this proceeding, the Surface Transportation Board ("STB" or "Board") is considering under 49 U S C §§ 11321-26 whether to approve, reject, or condition its approval of the application filed on December 5, 2007, for Canadian Pacific Railway Corporation ("CP") and Soo Line Holding Company, a Delaware Corporation and indirect subsidiary of CPC ("Soo Holding"), to acquire control of Dakota, Minnesota & Eastern Railroad Corporation ("DM&E") and Iowa, Chicago & Eastern Railroad Corporation ("IC&E"), a wholly owned rail subsidiary of DM&E.[1] The Transaction has been deemed "significant" for purposes of consideration under 49 U S.C. §§ 11321-26.

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[1] The proposal is referred to as the "Transaction," and CP, Soo Holding, DM&E, and IC&E are referred to collectively as "Applicants " CP and its U S rail subsidiaries, Soo Line Railroad Company ("Soo") and Delaware and Hudson Railway Company, Inc. ("D&H"), operate a transcontinental rail network over 13,000 miles in Canada and the United States and will be collectively referred to as "CP." DM&E and IC&E operate over 2,500 miles of rail lines serving either U.S. states and will be collectively referred to as "DME."

On March 4, 2008, KCSR filed its Comments and Request for Conditions ("Comments"). KCSR requested that the Board impose certain conditions to preserve the competitive routing options currently available to shippers and receivers located on the lines of DME and KCSR In support of its request for competition-preserving conditions, KCSR began by noting that DME – (1) plays a critical role in providing shippers with direct, single-line service to the major rail gateways of Chicago, Kansas City, and Minneapolis/St. Paul, and, (2) given that it connects with all seven Class I carriers and is independently owned and operated, provides shippers and receivers with neutral interline access for long-haul movements to markets beyond the geographic reach of the existing DME system. The agreements with KCSR via the so-called "Grain Agreement"[2] and the "Chicago Agreement"[3] were examples whereby shippers and receivers benefitted from the neutrality of the DME system.

KCSR demonstrated that CP will have different economic incentives and strategic goals than the current DME system and will use its control to destroy the neutrality of the DME system. In particular, CP would use its market power and control of DME to divert DME corn that currently flows to domestic feed lots serving the south-central poultry markets to the export markets in the Pacific Northwest ("PNW") via the current CP/Union Pacific ("UP") alliance or the DME/BNSF grain agreement Such diversion would eliminate a primary source of grain for KCSR-served feed mills in the south-central United States and force KCSR-served receivers of corn to pay more to receive the same product from other sources. KCSR also demonstrated that,

[2] As described in KCSR's Comments, the Grain Agreement gives KCSR ratemaking authority for the transportation of grain from IC&E origins in Iowa and Minnesota to destinations in Texas, Oklahoma, Kansas, Missouri, Arkansas, Mississippi, Louisiana, and Alabama (i.e., the south-central United States)

[3] Also as described in KCSR's Comments, The Chicago Agreement grants KCSR pricing authority between Kansas City and Chicago for chemicals, forest products and other carload customers.

where DME had been a willing and cooperative partner in the movement of traffic through the Kansas City gateway, CP works with UP for the movement of NAFTA traffic. As such, in a post-Transaction world, CP will seek to eliminate or discourage a KCSR-IC&E(CP) routing in the Laredo-Kansas City-Chicago market This will result in a reduction of competition as one of the few non-UP routes for NAFTA traffic will no longer be an effective alternative for shippers in the critically important Laredo-Kansas City-Chicago corridor.

In light of the concerns that KCSR articulated in its Comments, concerns which have been independently confirmed through subsequently filed shipper statements, and in part, through the initial and reply comments filed by the United States Department of Agriculture ("USDA"), KCSR and others urged the Board to condition its approval of the Application upon certain narrowly-tailored conditions by: (1) making permanent KCSR's existing ratemaking authority for the origination of corn from DME origins; (2) ensuring that CP takes no action to degrade the transit times over the existing DME-KCSR routings, and (3) ensuring the permanence of KCSR's ratemaking authority to/from the Chicago gateway

In its filing of April 18, 2008, entitled "Applicants' Response to Comments and Requests for Conditions and Rebuttal in Support of Application," ("Reply") the Applicants responded to KCSR's Comments. In the Reply, Applicants claim that domestic feed mills in the south-central U.S. are not dependent upon IC&E-originated corn, and even if they were, IC&E-originated corn will not be diverted to PNW export destinations because doing so is too costly and too circuitous Even if it is diverted, according to Applicants, domestic feed mills in the south-central U.S. can easily obtain corn from alternative sources without economic harm With respect to NAFTA traffic, Applicants claim that the KCSR-IC&E routing is not an effective routing today, and if that routing is no longer available in a post-Transaction environment, shippers will still have numerous alternative routings available to them. In their view, Applicants' open gateway commitment[4] will resolve any competitive issues arising from the Transaction. Therefore, according to Applicants, the concerns raised by the KCSR shippers and the USDA are unfounded and/or do not warrant exercise of the Board's conditioning authority.

As KCSR will demonstrate through the Rebuttal Verified Statements of Michael Bilovesky (Exhibit A)("R V S Bilovesky"), George Woodward (Exhibit B)("R V.S Woodward"), and Dr Curtis Grimm (Exhibit C)("R V S Grimm"), feed mills in the south-central U S do in fact depend upon IC&E-originated corn for which CP will seek to divert to PNW routings KCSR's rebuttal evidence demonstrates that CP has both the ability and the economic incentive to divert this corn to PNW destinations and thereby force these users to obtain corn from alternative sources at higher prices Likewise, due to its alliance with UP, CP will degrade or otherwise seek to eliminate the KCSR routing in the Laredo-Kansas City-Chicago corridor and will either interchange Kansas City-Chicago traffic with UP at Kansas City, discriminating against KCSR, or will favor its existing CP-UP routings through Minneapolis/St Paul and Chicago for NAFTA traffic As such, the Transaction will eliminate one of the few remaining routing options independent of UP for traffic in the Laredo-Kansas City-Chicago corridor. Accordingly, should the Board grant the Application, it should exercise its conditioning authority to preserve shippers' existing competitive options by imposing the requested conditions on the Transaction.

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[4] The fact that Applicants, who have previously denied that the Transaction would result in any competitive consequences, have offered an "open gateway" commitment and condition is itself an acknowledgement that KCSR, shippers, and others, including the USDA, have raised legitimate competitive concerns that warranted a condition. Standing alone, however, such a commitment does not sufficiently address all of the concerns

ARGUMENT

I. THE TRANSACTION WILL RESULT IN A REDUCTION OF COMPETITIVE OPTIONS CURRENTLY AVAILABLE TO GRAIN BUYERS IN THE SOUTH-CENTRAL UNITED STATES

In its Comments, KCSR provided detailed evidence showing that KCSR-served feed mills located in the south-central U.S. currently depend upon IC&E-originated corn off of the Corn Lines as a low cost source of feed for use in the poultry markets Corn received by these feed mills is transported pursuant to the Grain Agreement whereby KCSR has pricing authority to market the transportation component of corn that originates at certain stations on IC&E. This arrangement allows grain elevators located on the Corn Lines to choose whether to ship to KCSR destinations and provides domestic receivers (feed mills) that are served by the KCSR in the states of Arkansas, Oklahoma, Mississippi, Texas, Kansas, Missouri, and Alabama, with the option to buy corn from IC&E origins. Because the Grain Agreement has no minimum volume requirements or penalties, shippers and receivers have the option, but not the obligation, to use it. As such, the market price of corn, combined with the transportation rates provided by all of the connecting Class I carriers, determines where IC&E-originated corn off of the Corn Lines is ultimately delivered.

KCSR comments proved that the Transaction would destroy the neutrality of the Grain Agreement KCSR established that CP has different economic incentives than the DME system and would change the service or price terms of the current IC&E-KCSR routings to foreclose the routing options to the south-central U S. and favor CP long-haul routings. In particular, CP will seek to encourage routing IC&E-originated corn to the PNW export markets because doing so provides CP with more profit per car than CP could obtain under the Grain Agreement KCSR established that the incentive for such traffic diversion was so strong that CP would, during the pendency of the Grain Agreement, have an incentive to reduce service and transit times, and then later, upon expiration of the Grain Agreement, seek to change pricing and car supply terms, so as to render the IC&E-KCSR routings ineffective. In doing so, CP would force feed mills that depend upon IC&E-originated corn to obtain other sources of corn, which could be done, but at much higher cost.

In response to KCSR's Comments, the Applicants claim, in essence, that – (1) KCSR-served feed mills do not depend upon IC&E-originated corn; (2) CP will not be able to divert IC&E corn to the PNW; and (3) even if diversions were to occur, KCSR-served corn receivers have other sources available to them at comparable cost. The Applicants' Reply evidence is unpersuasive, as KCSR and its rebuttal witnesses will show

A. <u>Many Feed Mills In The South-Central U.S. Do Depend Upon IC&E-Originated Corn</u>

As discussed by Mr Bilovesky, the Grain Agreement, which took effect over ten years ago and expires in [redacted], allows KCSR to quote rates from IC&E corn origins, mainly on the so-called Corn Lines in northern Iowa and southern Minnesota. [redacted] Under the agreement, KCSR gives IC&E 75-car unit trains at Kansas City. IC&E takes that unit train, breaks up into no more than 3 different unit sizes, and then delivers those units to up to three different origins for loading Once the cars are spotted at the last origin, the clock starts, and IC&E's shippers have [redacted] hours to load the train The IC&E crew then picks up the cars, reassembles them back into 75 car unit trains, and delivers them back to KCSR at Kansas City for movement to to the KCSR served feed mills. The Grain Agreement does not require IC&E to provide any minimum volumes to KCSR nor does it have service guarantees R V S Bilovesky at 19.

Because the DME system is currently commercially independent and connects with all Class I railroads without being affiliated with any of them it can function somewhat like a giant, independent switching carrier. Corn can move under the Grain Agreement as markets demand, because there is no contractual or affiliation-based impediment acting like a paper barrier to prohibit IC&E-originated from being interchanged to KCSR to serve in the south-central states or other carriers for transport to other markets As such, the market price of corn, combined with the transportation rates provided by all of the connecting Class I carriers, determines where IC&E-originated corn off of the Corn Lines is ultimately delivered.

As a result of this market driven arrangement, many feed mills that are served by the KCSR in the south-central U.S. have found that the lowest delivered price of corn is IC&E-originated corn that is routed under the Grain Agreement. Likewise, many grain elevators located on the Corn Lines, especially elevators that cannot load 75 or 100 car unit train sets, have also found that their best outlet for their corn is to KCSR destinations, especially due to the operating practices of IC&E and KCSR which allows train sets to be broken up to the smaller unit sizes necessary for loading and unloading at smaller elevators. Due to this symbiotic relationship, in 2006, KCSR delivered [redacted] carloads of IC&E originated corn to its feed mills and [redacted] carloads in 2007. For many of the feed mills, the IC&E originated corn represents the primary source of corn bought by that feed mill. R.V.S. Bilovesky at 5.

Applicants make much of the fact that many shippers and shipper organizations support the Transaction. Yet, that does not mean that other shippers and receivers will not be harmed For a few grain elevators on IC&E's line and for many of the buyers of that corn - i.e., the feed mills in the south-central U.S. - the Transaction will result in economic harm because of reduced market access. It is the concerns of these shippers and buyers that prompted KCSR's involvement in this proceeding

Applicants assert that they will resolve these concerns through their "open gateway" commitment While the Board should impose that commitment as a condition, that commitment is not sufficient to resolve the concerns of the shippers and buyers whose needs prompted KCSR's involvement in this proceeding. That commitment formed the basis of a settlement agreement with the Corn Line shippers group. Yet, Applicants offer no similar assurances to the feed mills that actually pay to transport the IC&E-originated corn to feed mills on KCSR In other words, those who actually pay the rail rates, and who will be directly harmed due to the loss of DME's neutrality, have no settlement agreement or assurances that they will not end up paying more for their corn

The concerns of these receivers are real concerns The harms to them are significant, despite Mr Williams' 2005 STB Waybill Sample analysis attempting to show otherwise. The harms that these individual KCSR-served feed mills would suffer cannot be minimized by *looking at* <u>*all*</u> *corn terminations (regardless of origin) from* <u>*all*</u> *railroads to* <u>*all*</u> *feed mills in the* various states in which the KCSR feed mills are located to downplay the significance of IC&E-originated corn Only by examining the impacts on the real buyers of IC&E corn - those served by KCSR who, for the most part, receive the majority of their corn needs from the Corn Lines, can one determine the adverse impacts caused by the Transaction.[5]

Mr Bilovesky's rebuttal statement, Exhibit 1, shows the feed mills served by KCSR that are at issue in this proceeding. Contrary to Mr. Williams' analysis which is based solely on the 2005 Carload Waybill Sample (Reply V S. Williams at 15-17), KCSR does in fact serve feed mills in the states of Alabama, Arkansas, Oklahoma, Louisiana, Mississippi, and Texas Indeed,

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[5] CP and DME combined may not control a large percentage of all corn originations when compared to other railroads, as noted by Mr. Williams in his verified statement (Reply V S. Williams at 3-6). The fact that there may be other railroads that deliver corn to other feed mills in that same state as those that KCSR serves does not establish that the KCSR-served feed mills can turn to these alternative sources of corn without having to pay more In fact, for a significant number of KCSR-served feed mills, IC&E-originated corn represents the lowest price corn and buying such corn from another source would cost more. As a result, that feed mill would be economically harmed as a result of the Transaction R V.S Bilovesky at 6-7.

KCSR has, in the 2005-2007 period, delivered IC&E corn to the KCSR-served feed mills in all of those states, except for the state of Alabama, Mr. Williams' waybill analysis notwithstanding

For many of the KCSR-served receivers, IC&E-originated corn is the largest single source of corn R V S Bilovesky at 5. Mr Williams attempts to minimize the role KCSR plays in meeting the needs of these feed mills by claiming that "IC&E originated corn accounted for only [redacted] of the corn delivered by rail to the states of Arkansas and Oklahoma in 2005" (Williams Reply V.S. at 17)(emphasis in original). That analysis misses the point IC&E-originated corn may only have accounted for [redacted] of all corn delivered by rail to the entire states of Arkansas and Oklahoma in 2005 (Williams includes corn delivered from all other origins from all other railroads to derive his [redacted] figure), but for the specific feed mills in those *states that are served by KCSR, IC&E-originated corn accounted for almost* [redacted] *of their rail* delivered corn for 2006 and 2007. R.V.S. Bilovesky at 6.

It doesn't matter if other carriers, such as UP, BNSF, CN, and NS, deliver a larger percentage of the total amount of rail-delivered corn to a particular south-central U.S state than does KCSR. Those other carriers are delivering corn to the feed mills that they serve. The other feed mills that they serve are, in most cases, in competition with the KCSR-served feed mills in those very same states. What matters to the KCSR-served feed mill then is not the availability from other sources or other railroads, but rather their ability to obtain corn at the lowest delivered price. For a significant number of KCSR-served feed mills, that lowest delivered price corn is IC&E-originated corn.

The importance of IC&E-originated corn for these feed mills has been confirmed by the buyers themselves in statements filed with the Board

> As noted in my November 30 statement, Tyson has multiple poultry feed mills in Arkansas, Oklahoma, and Mississippi Those mills receive a substantial amount of their overall corn needs from The Kansas City Southern Railway Company

> ("KCSR") All of that KCSR delivered corn comes from Iowa and Minnesota via IC&E origins pursuant to an agreement between IC&E and KCSR that allows KCSR to price and market the rail transportation component of the IC&E originated corn.

Mr John Grass, Vice President – Input Exposure, Management Desk, Tyson Foods, Inc , one of the largest poultry companies in the world

> Our clients tend to buy F O.B origin and thus end up paying for the transportation themselves, therefore it is very important that there not be any reduction in those transportation options . Many of our clients have multiple poultry feeds mills in Arkansas, Oklahoma, and Mississippi. Those mills receive a substantial amount of their overall corn needs from The Kansas City Southern Railway Company ("KCSR") Most of that KCSR delivered corn comes from Iowa and Minnesota via IC&E origins pursuant to an agreement between IC&E and KCSR

David W. Nutt, President, J W. Nutt Co , which offers brokerage service and purchases corn for Pilgrim's Pride, Tyson, George's Farms, and OK Industries.

> We currently operate two feed mills located in Arkansas and Oklahoma served by The Kansas City Southern Railway Company ("KCSR"). We received in excess of 11,000 carloads of corn and soybean meal annually at our feed mills Those mills received the majority of their overall corn needs from KCSR A portion of that KCSR delivered corn comes from Iowa and Minnesota via IC&E origins pursuant to an agreement between IC&E and KCSR.

Mr. Russell E. Bragg, Division President, OK Industries, Inc These statements belie the conclusions of Mr. Williams that IC&E-originated corn is not an important source of corn to the KCSR-served feed mills Indeed, these three buyers of IC&E-originated corn represent [redacted] of the total IC&E-originated corn delivered to the south-central U.S states of Arkansas, Mississippi, and Oklahoma by KCSR R V S Bilovsky at 11 All of them agree that IC&E corn is an important source of corn in their business and that an unconditioned transaction would result in economic harm.

B. CP Has A Strong Economic Incentive To Divert DME Corn To The Pacific Northwest

As previously noted, because there are no contractual or affiliation-based barriers that prohibit IC&E from interchanging IC&E-originated corn with the connecting Class I carriers, the market price of corn, combined with the transportation rates provided by all of the connecting Class I carriers, determines where IC&E-originated corn is ultimately delivered. That decision is an economic one driven by market forces, not by the market power of the originating carrier, i.e. the DME system CP control will change this dynamic. CP will use its market power over the IC&E corn originations to price the transportation component from those origins in such a way as to encourage routings to CP long haul routes[6] to maximize the contribution of this traffic to the CP system.

As Mr. Woodward demonstrated in his Exhibit 7 to his original Verified Statement, IC&E's average contribution for traffic that moves under the Grain Agreement is [redacted][7] while CP makes a contribution of [redacted] for moving grain to the PNW via the CP-UP routing protocols. Mr. Woodward noted that Applicants therefore had a strong incentive to route corn originating on the Corn Lines to PNW routings in a post-Transaction environment. Contrary to the basic principle that railroads will always attempt to seek the long haul whenever possible and the analysis provided by Mr. Woodward in KCSR-2, Exhibit C, the Applicants insist that CP will

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[6] Both DME and CP move traffic to the PNW today CP moves grain out of the grain producing states, including origins near the Corn Lines, to the PNW via CP single-line service to Vancouver or via the CP-UP routing agreements. DME moves its grain to the PNW via interchanges with BNSF via the DME-BNSF agreement. These two routes - i.e the CP-UP route and the DME-BNSF route - actually compete against each other for the movement of grain to the PNW and the export markets. This is an example of the type of horizontal competition which has not been adequately analyzed by the Applicants

[7] Upon further analysis, Mr. Woodward has determined that IC&E's average contribution was actually overstated The differences between his revised estimate and his original estimate are discussed in his Rebuttal Verified Statement at R V S Woodward at 12-14

not attempt to route the IC&E corn to the PNW to the detriment of KCSR-served receivers because doing so would be too circuitous to be practicable and that such service would not provide CP with as much contribution per carload as CP would receive via the Grain Agreement Applicants have put forth the reply statement of Mr Williams to support this argument.[8]

Applicants insist that Mr. Woodward's contribution calculations for PNW traffic are flawed because he has applied URCS costs to the portion of the CP-UP interline move that occurs in Canada (i.e., between Portal, ND, and Eastport, ID) The Applicants maintain that URCS is a U.S. costing model that cannot or should not be applied to the portion of a through movement that occurs north of the border. The Applicants insist that Mr. Woodward should have used a Canadian costing model (the Canadian Transportation Agency's Agency Regulatory Costing Model – "ARCM"). Using this model, Mr. Williams attempts to prove, in particular in his JHW-14 exhibit, that existing CP-UP grain moves to the PNW do not produce nearly the contribution that Mr. Woodward claims Purportedly applying the same methodology he employed to determine CP-UP routings, Mr. Williams claims that CP would have a negative

[8] Despite KCSR discovery requests for any agreements governing DME's or CP's movement of grain to destinations other than KCSR's destinations, and the Board's decision to deny KCSR's motion to compel discovery of such agreements on the basis that no such agreements existed, Applicants, in the Reply, provide for the first time a [redacted] They also produced, for the first time, several agreements governing CP's shipment of grain to the PNW in conjunction with UP See Applicants' Reply, Vol. 2 at Tabs A, B, & E. The Board can see for itself now that these agreements were clearly responsive to KCSR's discovery requests and should have been produced. The fact that they were not shows that Applicants apparently believe they can withhold relevant documents with impunity In light of Applicants' actions, the Board needs to carefully examine the veracity of Applicants statements and representations

contribution from two proposed IC&E-CP-UP routings,[9] if CP attempted to divert Corn Line corn to PNW routings.

As Mr. Woodward explains in his Rebuttal Verified Statement, Mr. Williams' analysis is fatally flawed because it is largely dependent upon a costing model that is inconsistent with URCS and that artificially skews results in favor of the Applicants' arguments. R V.S Woodward at 17-21. Mr. Williams' uses one methodology to determine the costs and contributions on the existing CP-UP route ([redacted]), and despite claiming to use that same methodology with respect to a proposed post-Transaction IC&E-CP-UP route ([redacted]), he actually does not use the same assumptions and methods As a result, he has developed an apples to oranges comparison that does not accurately reflect the contribution that CP would receive by routing Corn Lines traffic to the PNW. When those inconsistencies are corrected, the analysis clearly shows that CP would in fact make a positive contribution from routing IC&E corn to the PNW and such a contribution would be more than what CP would make by routing the traffic to KCSR-served destinations via the Grain Agreement. R.V.S. Woodward Exhibits 7a, 7b, 7c, 7d, 9a, and 9b

A major flaw in Mr. Williams' analysis is his combining URCS costs for the U.S. portion of the route and ARCM's costs for the Canadian portion of the move ARCM is an unproven and inappropriate proxy for URCS and there is no legal precedent for its use by the Board There does not appear to be one case where the ICC or STB ever adopted and/or utilized ARCM costing in lieu of the STB's URCS costing in a regulatory proceeding URCS is the appropriate costing method Indeed, the use of URCS as the appropriate costing model to cost the foreign

[9] The routings are Algona, IA to Seattle and Winnebago, MN to Seattle. Algona and Winnebago are stations on the Corn Lines that currently ship corn to the KCSR-served feed mills.

portion of a cross-border move has been specifically endorsed, and required, by the STB [10] Mr. Woodward's analysis uses the appropriate URCS costs while Mr Williams' analysis does not.

Applicants seem to use ARCM solely for the reason that it helps their case, not because it is the Canadian equivalent of URCS. In fact, the underlying premise of the Applicants' use of ARCM is that it is a Canadian model; they make no attempt to compare it to URCS or explain the differences in the inputs between the two costing models Mr. Williams also does not explain why CP's costs are accurately measured by ARCM and not URCS He produces no studies which would demonstrate that CP's unit costs are substantially different than Soo's unit costs so that URCS would be an inappropriate model to use for the CP portion of the route [11]

As Mr. Woodward had suspected, and is able to prove through a sampling of corn traffic movements, the ARCM model provides per car-mile costs that are far higher than U.S. per car-mile costs for roughly equivalent services. R.V.S. Woodward at 18 and Exhibit 8. In addition, Mr. Woodward shows that, when ARCM costs are applied to the Canadian portion of the existing CP-Soo corn movements to the PNW via UP, the average per car contribution is hundreds of dollars lower than what other railroads are today obtaining for similar corn flows over equally or more distant routes and is significantly lower than what CP is more accurately able to obtain.

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[10] Simplified Standards For Rail Rate Cases, STB Ex Parte No. 646 (Sub-No. 1) at 100 (STB served Sept 5, 2007("We conclude that our simplified proposal will apply fully to cross-border traffic [fn] For the Canadian portion of a movement, we will use the URCS data for its U S subsidiary to estimate the operating costs for the entire movement Similarly, for the Mexican portion of a movement, we will use the URCS data for its U S counterpart, where available, or regional URCS otherwise.").

[11] The Applicants' witness, Mr. John H Williams, baldly asserts that the ARCM's "costs are the equivalent of URCS costs for Canadian regulatory purposes." Applicants Reply, Reply V S Williams at 13 Mr. Williams does not profess to be an expert in the use of ARCM, does not explain for what sort of "regulatory purposes" ARCM is applied, and nowhere demonstrates how ARCM is similar to or differs from URCS. Mr. Woodward's statement demonstrates the fallacies of Mr. Williams' unjustified substitution of ARCM for URCS.

Applicants have simply failed to show that ARCM is an accurate, reliable, or suitable counterpart to URCS for costing purposes URCS is the accepted costing methodology for STB purposes and there is no reason to believe that URCS measures Soo's costs accurately but somehow doesn't measure CP's costs accurately Accordingly, Mr Woodward's costing and contribution evidence as set forth in his Rebuttal Verified Statement uses URCS and represents a far more accurate and credible picture than Mr Williams' mix and match approach with respect to costs

In addition to the flaws associated with mixing and matching between URCS and ACRM, Mr Williams' claim that he developed the costs that CP "would incur in transporting corn from IC&E to PNW export terminals" for movements from Algona, IA and Winnebago, MN using "*the same methodology*" (Reply V.S. Williams at 14)(emphasis added) that he used to develop the costs for the CP-UP movements to Seattle, WA from Glenwood, MN, Enderlin, ND and Oakes, ND is not accurate. In fact, Witness Williams employed a very different costing methodology for the IC&E portion of the movement from Algona, IA and Winnebago, MN to Portal, ND than he did for the similar portion of the movement in the CP-UP routing to the PNW. In particular, the per car-mile URCS cost that Mr Williams uses for the U S. portion of the IC&E-CP-UP routing is [redacted] higher than his URCS costs for the U S portion of the existing CP-UP corn movement to Kingsgate. R.V.S. Woodward at 23 Another flaw is that he uses [redacted] in lieu of unit train costing for the IC&E movements to Portal but uses unit train costs for the CP-UP moves to Portal.[12] This results in an

[12] Witness Williams has erroneously assumed that the [redacted] car movements would move in average train service and would not form into unit trains until the cars move all the way to Portal, which is 883 miles from Algona and 841 miles from Winnebago This results in reduced economies, added costs, and additional "make whole" adjustments that do not apply to unit train movements. Given how IC&E and KCSR cooperate today, with IC&E building unit trains out of

overstatement of the costs. Mr Williams then compounds his error by comparing these [redacted] with revenues on existing BNSF and UP shuttle train rates

Mr. Woodward shows that STB-approved methods of costing prove that routing IC&E corn to PNW destinations via an IC&E-CP-UP route would earn CP much more contribution than Witness Williams shows and significantly more than CP would get routing that corn to KCSR destinations via the Grain Agreement Mr Woodward has identified specific IC&E stations from which KCSR-served receivers obtained corn and has then identified the route (or routes) by which corn from these same stations would flow to the PNW in a post-Transaction CP-DME system Mr. Woodward has then applied URCS costs to the through movement to determine the costs associated with the movement, and has apportioned contribution among CP and UP in accordance with the UP revenue requirements set forth in the [redacted] (which governs the CP-UP interline movement of grain to the PNW) Mr. Woodward's estimates show that CP stands to earn on average approximately [redacted] in contribution from such movements, as compared to on average approximately [redacted] for movements from the same IC&E stations to Kansas City under the Grain Agreement. See R.V.S. Woodward at Exhibits 7c and 7d. Thus, in contrast to the negative contribution projected by Mr Williams' inflated costing mechanisms, CP will have considerable economic incentive to divert corn to the PNW and away from domestic receivers on KCSR.

Another illustrative example of CP's economic incentive to route IC&E corn to the PNW is to restate the relevant movements contained in Mr. Williams' Highly Confidential Exhibit JHW-14. As can be seen in the R.V.S. Woodward, Exhibit 9a, using [redacted] URCS and the

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[redacted] car lots before tendering them to KCSR, it is more than likely that IC&E-CP-UP moves would likewise move in unit train service, not in average train service as Mr. Williams assumes.

same methodology and assumptions for both the CP-UP moves and the IC&E-CP-UP moves,[13] Mr. Woodward shows that Mr. Williams clearly understates CP's contribution for existing CP-UP moves to the PNW and significantly overstates the costs associated with post-Transaction IC&E-CP-UP moves to the PNW.[14] Mr. Woodward also produced Exhibit 9b using 2005 URCS data and the same assumptions that he used in his Exhibit Nos 7a-7d.[15] This, too, shows significant positive contribution to CP. Regardless of how one restates Mr Williams' JHW-14, when URCS costs are applied, the numbers clearly show that CP has a considerable economic incentive to divert corn to the PNW and away from domestic receivers on KCSR

Although Mr. Bilovesky, as an in-house KCSR employee in the marketing department, cannot view waybill data or opine on the specific revenue factors used by Mr. Woodward and Mr Williams, his own independent analysis confirms Mr. Woodward's conclusion that CP will have an economic incentive to route IC&E corn to the PNW. Mr. Bilovesky points out that UP has published rates from Sheldon, IA (which is located on the Corn Lines) to the PNW[16] at a rate of $4610 for cars less than 5,001' cubic capacity and a rate of $5,048 on cars greater than 5,001'

[13] Curiously, while Mr. Williams used 2005 data for most of his studies, he used the STB's [redacted] URCS data for his JHW-14 exhibit; a fact one would not know unless one reviewed the workpapers. Mr. Woodward's Exhibit 9a uses [redacted], in order to maintain an apples to apples comparison with Mr. Williams' analysis. He also used Mr. Williams' parameters of [redacted] Like Williams, Mr. Woodward also applied an index of [redacted], which also appears high, to update the costs to current levels

[14] [redacted]

[15] [redacted]

[16] Mr. Bilovesky uses UP's published rate from an origin on the Corn Lines as a proxy for the rate that CP could charge from the Corn Lines to the PNW. [redacted]

cubic capacity. Using mileages supplied by Mr. Anderson, Mr. Smith, and Mr. Williams in their verified statements, Mr Bilovesky points out that it would take IC&E-CP-UP 2,192 miles to get to the PNW from Algona, IA and 2,155 from Winnebago, MN Sheldon, IA would add 84.6 miles to the Algona, IA mileage for a total of 2,276.6 miles to the PNW (from PC*Miler Rail Version 14.0). Based on the assumption that IC&E-CP-UP divide the revenue on a mileage prorate basis and using the UP published rate as the market prices, Mr Bilovesky concludes that such a mileage prorate would give each party $2.02 per mile on small cube cars and $2 22 per mile on larger cube cars. For IC&E-KCSR feed mill business today, IC&E receives between [redacted] and [redacted] per car from Sheldon, IA to Kansas City, a distance of 714 3 miles. That equates to [redacted] per mile. R.V.S. Bilovesky at 24 Obviously, CP would rather collect $2 02 and $2 22 per mile and $4610 to $5,048 per car routing to the PNW than [redacted] per mile and [redacted] per car by routing to a KCSR-served destination [17]

Applicants' additional argument that the ICE-CP-UP route to the PNW is too circuitous to warrant re-routing Corn Lines traffic to the PNW is unsustainable in light of Mr. Woodward's and Mr Bilovesky's conclusions. Mr. Woodward's analysis shows that the route by which the Applicants would move to reach the PNW provides a contribution sufficient to render any circuity argument nothing more than a red herring Indeed, the Algona, IA to Seattle route is 2,388 miles. This route is only slightly longer than the DME-BNSF route from [redacted], which route is 2,289 miles and moves corn today. The fact that actual

[17] Mr. Bilovesky's per mile revenue figures are [redacted] The route miles from Algona, IA to the PNW via the IC&E-CP-UP routing are 2,388 miles (CP 1,694 miles; UP 694 miles). Assuming an average revenue of [redacted], gives a per car revenue of [redacted] to CP (or [redacted] per mile) and [redacted] (or [redacted] per mile) to UP. This confirms the basic premise of Mr. Bilovesky's analysis that CP would make more revenue per-car mile routing the Algona traffic to the PNW than routing it to Kansas City for interchange to KCSR

corn from one of the Corn Lines stations is moving to [redacted] clearly establishes that routing Corn Lines corn to the PNW is not too circuitous, as Applicants claim. Given the higher contribution that CP would receive from a PNW routing, the slightly longer route from Algona, IA to the PNW is irrelevant Corn Lines corn can and does move over routes of similar length today, and CP will have every incentive to move such corn over its CP(IC&E)-UP route in a post-Transaction environment This refutes the assertions by Mr. Anderson and Mr Smith that Corn Line routings would not be "competitive, on either a cost or service basis, with BNSF's direct route to the PNW " They can be and will be if CP takes control of DME [18]

Finally, Applicants maintain that, even if it were in CP's economic best interest to maximize its profits by routing more corn in interline service with UP, the [redacted] would not allow that to happen. [redacted] Reply V S. Smith at 5. On the other hand, given the contribution

[18] In a similar manner, Mr Bilovesky points out that today, in conjunction with DM&E, the BNSF has rates published out of New Ulm, MN at $3420.00 per car using the DM&E/BNSF route via the Florence interchange Even at these rate levels, CP could, Mr Bilovesky suggests, route this traffic from New Ulm, MN to Seattle via the CP-UP routing over Kingsgate, which, using Mr Anderson's mileage calculation, would be a 2,140 mile move. According to Mr Bilovesky, this more circuitous route would still give CP $1.60 per mile. That number increases to $1 78 per mile if CP were to use jumbo covered hoppers over the same route. [redacted], CP would still earn more moving it to the PNW via the CP-UP route than it makes moving it to KCSR. R V S Bilovesky at 25.

that UP would receive for adding DME origins, it would not make economic sense for UP to [redacted] The potential contribution from increased export corn traffic moving via this route and other opportunities presented to UP as a consequence of the proposed Transaction could very easily result in a revised agreement allowing for additional corn traffic. Of course, in the end, if [redacted], there are no similar limitations on [redacted] Nothing would prevent CP from routing IC&E corn via that route and in doing so, at least match the contribution it receives from routings to KCSR at Kansas City

On a related note, while not directly addressing the issue of CP's economic incentive to route Corn Lines corn to the PNW, Applicants' arguments surrounding the impossibility of IC&E corn diversions to the PNW conflict with their presentations to DME shippers and the expectations of those shippers Taken together, the Application and Reply convey the notion that DME corn growers will enjoy post-Transaction benefits associated with single-line service to Duluth/Superior, the eastern U.S., and Canada, but Corn Lines shippers will not enjoy single-line access to the PNW export markets, notwithstanding Applicants' public assertions otherwise This position, which only clearly emerges when reading the Application and Reply together, conflicts with the support statements that the Applicants have obtained from the shippers, including the Corn Lines shippers. Such shippers frequently identify improved "single-line" access to PNW markets as a benefit of the Transaction and list this benefit among the reasons persuading them to support the Application or enter into settlement agreements.

For example, the City of New Ulm, MN adopted a resolution, which was included in the Reply, that supports the Transaction because the Transaction would provide "desirable *single-*

line service to the East and West Coasts " Yet Mr. Anderson's reply statement (Reply V.S. Anderson at 3-7) states that diverting shipments from New Ulm or other origins to CP-UP routings or CP single-line routings to the PNW would not happen due to the circuitous nature of such routes. If Mr. Anderson were correct, New Ulm shippers would not benefit from new single-line service to the West Coast, although apparently they have been told that they would. Similarly, Mr. Russ Lucas on behalf of the City of Claremont, Minnesota, states. "Without having to resort to other modes of transportation, our shippers will be able to reach markets east of Chicago as well as markets in the *Pacific Northwest on the Canadian Pacific's reliable and efficient single-line service* " As with New Ulm, and according to Mr Anderson's analysis and that of Mr Smith, the City of Claremont is also not going to benefit from CP single-line service to the PNW.

The Corn Line shippers also apparently believe that the Transaction will result in single-line access to the PNW The Southern Minnesota and Northern Iowa Shippers Association, which represents "virtually all of the 46 grain elevators located on IC&E," says (emphasis added)·

> [T]he transaction will give our members single-system access to a variety of additional destinations for their grain shipments, including the ports of Duluth/Superior, the U.S. Northeast and points throughout both eastern and western Canada Such access will provide our members opportunities to tap new markets, and enable them to compete more effectively with elevators served via CN single line service *CP Service to the Pacific Northwest will offer an additional competitive option for corn shipments moving to export markets*

But the Reply states that Corn Lines shippers will not have CP service to the PNW because such routings would be too circuitous, unprofitable, or the CP-UP [redacted] would not allow for it. Applicants appear to be speaking out of both sides of their mouth When dealing with DME shippers, new PNW export market access is indeed possible, but when rebutting KCSR's arguments, routing DME corn to the PNW single-line service to the export market is out of the question Either DME shippers who have supported the Application or entered into settlement agreements are in for a rude awakening, or the Applicants are being disingenuous in their Reply

In the end, as Mr Woodward has demonstrated, and as is confirmed by Mr. Bilovesky's market experience, Applicants will obtain a higher contribution by routing IC&E corn traffic to the PNW than by moving it under the Grain Agreement. Applicants have a strong economic incentive to route corn to PNW routings in a post-Transaction environment In doing so, Applicants would simply be following the basic principle that railroads will always attempt to seek the long haul If Applicants are not going to route DME traffic to the PNW markets, then Applicants have misled the shippers, the Board, and others regarding the alleged benefits of the Transaction

C. <u>Elimination Of IC&E Corn As A Readily Available Source Will Result In Economic Harm To Shippers And Receivers</u>

Arguing in the alternative, Applicants have argued that even if corn is diverted to PNW destinations, KCSR-served feed mills could simply turn to other sources of corn to fill the void. Rather than deal with theories and hypotheticals put forth by Applicants, it is best to let the users of the IC&E-originated corn speak for themselves about what would happen if the IC&E-originated corn was no longer available to them because it was being diverted to other end users as a result of the market power gained by CP and the loss of DME neutrality

> Any loss of those Iowa and Minnesota origins would require Tyson to receive corn from other KCSR origins, most likely Council Bluffs. This would result in Tyson having to pay more for its grain because the delivered price is significantly more than the grain available from the DM&E and IC&E origins.

John Grass, Tyson Foods

> Any loss of those IC&E Iowa or Minnesota origins would require OK to receive corn from other locations. This would result in having to pay more for its grain

Russell Bragg, OK Industries, Inc

> J.W. Nutt Company supports the request by KCSR to ensure that the existing routing agreement with IC&E for Iowa and Minnesota originated corn remains available for the long term. Any loss of those IC&E Iowa or Minnesota origins would require our clients to receive corn from other locations and would result in their having to pay more for the rail component and the grain.

David W. Nutt, J.W. Nutt Co. Applicants' witnesses ignore these very real statements by the receivers that buying corn from other non-IC&E origins would result in increased prices. Instead, Applicants focus on incomplete and highly aggregated data in an attempt to prove their case that alternative sources of corn are available to KCSR-served feed mills and at a lower delivered cost basis.

Mr. Williams argues that Mr. Bilovesky's contention that KCSR-served receivers will incur additional costs to acquire corn was not supported by any quantitative data He then attempts such a quantitative analysis. (Williams Reply V S at 20-22). He compares the average revenue per car from Iowa and Minnesota origins (he does not say that his average revenues are from actual Corn Lines stations) to all destinations in Arkansas and Oklahoma (which, as he notes, such states are also served by UP and BNSF)[19] with the average revenue per car from Omaha/Council Bluffs and Atchison/Topeka (which are KCSR origins but are also origins for UP and BNSF)[20] to these same destination states (but not to specific KCSR-served feed mills) Adding in corn prices, he then comes to the conclusion that the KCSR-served feed mills could have obtained corn from the alternate origins and would not have suffered economic harm from doing so.

[19] He does not say that the average revenue per car from the IC&E origins to these destinations is average IC&E-KCSR revenue To the extent IC&E is also interchanging corn to UP and BNSF, who also serve the same destination states as KCSR, then the average revenue per car would include those carriers

[20] Here, because UP and BNSF also serve these origins and the destination states, the average revenue per-car appears to include UP and BNSF moves to those destination states as well as KCSR moves As such, this would not be an accurate picture of harm to KCSR receivers.

The problem with his analysis is that it is not specific to the actual IC&E moves at issue For IC&E origins, he is using an average rail rate that appears to be an average of all rail rates for all corn originating in Iowa and terminating at all feed mills in Arkansas or Oklahoma, not the specific IC&E-KCSR rate from the Corn Lines to the KCSR-served feed mills in Arkansas and Oklahoma. For the Omaha/Council Bluffs and Atchison/Topeka origins, he is again using an average rail rate for all rail moves from that origin, which appears to include rates offered by UP and BNSF as well as KCSR at those origins, to <u>all</u> feed mills in the states of Arkansas and Oklahoma, including destination feed mills solely served by UP and BNSF as well as the KCSR-served feed mills. He does not appear to be comparing the specific IC&E-KCSR rate from Iowa and Minnesota to the KCSR specific rates out of Omaha/Council Bluffs and Atchison/Topeka to the KCSR-served destinations in the states of Arkansas and Oklahoma As such, his analysis is incomplete

When one uses actual marketplace prices to actual KCSR destinations for actual customers, the "model" and "theory" posited by Mr. Williams falls apart. As Mr Bilovesky shows, using quantitative data based on the facts that exist today in the marketplace, one reaches a far different conclusion than Mr Williams. When comparing KCSR-only rates from the three origins to the same KCSR-only served destinations - a real world comparison - one reaches the following results.

JJR Spur, AR	Rail Rate	Price of Corn	Total Price	Difference
IC&E Origins	[redacted]	$4.81 x 3500 = $16,835 per car	[redacted]	
Kansas City	$1980.00	$5.04 x 3500 = $17,640 per car	$19,620	[redacted]
Council Bluffs	$2540.00	$4.92 x 3500 = $17,220 per car	$19,760	[redacted]

Hope, AR	Rail Rate	Price of Corn	Total Price	Difference
IC&E Origins	[redacted]	$4.81 x 3500 = $16,835 per car	[redacted]	
Kansas City	$1980.00	$5.04 x 3500 = $17,640 per car	$19,620	[redacted]
Council Bluffs	$2540.00	$4.92 x 3500 = $17,220 per car	$19,760	[redacted]

Waldron, AR	Rail Rate	Price of Corn	Total Price	Difference
IC&E Origins	[redacted]	$4.81 x 3500 = $16,835 per car	[redacted]	
Kansas City	$1910.00	$5.04 x 3500 = $17,640 per car	$19,550	[redacted]
Council Bluffs	$2460.00	$4.92 x 3500 = $17,220 per car	$19,680	[redacted]

Union, MS	Rail Rate	Price of Corn	Total Price	Difference
IC&E Origins	[redacted]	$4.81 x 3500 = $16,835 per car	[redacted]	
Kansas City	$2020.00	$5.04 x 3500 = $17,640 per car	$19,660	[redacted]
Council Bluffs	$2575.00	$4.92 x 3500 = $17,220 per car	$19,795	[redacted]

Craig, OK	Rail Rate	Price of Corn	Total Price	Difference
IC&E Origins	[redacted]	$4.81 x 3500 = $16,835 per car	[redacted]	
Kansas City	$1800.00	$5.04 x 3500 = $17,640 per car	$19,440	[redacted]
Council Bluffs	$2360.00	$4.92 x 3500 = $17,220 per car	$19,580	[redacted]

Hudson, OK	Rail Rate	Price of Corn	Total Price	Difference
IC&E Origins	[redacted]	$4.81 x 3500 = $16,835 per car	[redacted]	
Kansas City	$1615.00	$5.04 x 3500 = $17,640 per car	$19,255	[redacted]
Council Bluffs	$2170.00	$4.92 x 3500 = $17,220 per car	$19,390	[redacted]

R.V.S Bilovesky at 10-11.

Clearly, if Tyson were required to shift from IC&E origins to other KCSR-served grain origins, Tyson would have to pay more and would suffer economic harm at their six feed mills served by KCSR. Tyson understands the very real implications of the Transaction. That is why they support the Transaction on the condition that KCSR's ratemaking authority for IC&E-served origins remains in place. Likewise, J W. Nutt and OK Industries understand this as well Indeed, these three buyers of IC&E-originated corn represent [redacted] of the total IC&E-originated corn delivered to the south-central U.S states of Arkansas, Mississippi, and Oklahoma by KCSR All of them agree that, unless conditioned, the Transaction would harm them economically

Furthermore, Mr. Williams' assertion that corn that originates on UP, BNSF, CN, or NS, while certainly available to KCSR-served feed mills in Arkansas and Oklahoma via an interchange with KCSR, is going to interchanged to KCSR and delivered to the KCSR-served *feed mills at a total delivered price less than the IC&E-KCSR rail rate is unrealistic* R V S. Bilovesky at 11-12. Likewise, Mr. Anderson's view (Reply V.S. Anderson at 12) that locally grown corn can replace IC&E corn as an alternative source is not shared by Mr. Bilovesky (or, for that matter, the actual feed mills themselves who have provided statements of competitive harm). While locally grown corn is used by some of the KCSR feed mills today, at most of the KCSR feed mills such locally grown corn has not traditionally been, nor is it likely to be, a readily available source at comparable prices to the IC&E corn. R.V.S. Bilovesky at 12 The bottom line is that IC&E-KCSR delivered corn represents the lowest delivered price for a number of KCSR-served feed mills and having to obtain that corn from another source will result in economic harm to those feed mills.

Even if CP cannot alter KCSR's ratemaking authority during the term of the Grain Agreement, CP can effectively undercut the agreement Because the Grain Agreement contains no volume commitments or meaningful service standards, CP can simply use its control of the IC&E origins to downgrade service during the pendency of the Grain Agreement so as to disincentivize movements to KCSR destinations and encourage routings to the PNW CP claims it won't downgrade the transit times by reducing turn times on KCSR equipment because of the service penalties contained within the Grain Agreement. Yet, the [redacted] per car per-day service penalty is a small penalty and represents less than [redacted] of the per-car revenue that IC&E receives. This is not much of a penalty, especially when contrasted to the contribution that CP can gain by encouraging diversion of IC&E corn to other destinations like the PNW.

Indeed, it is clear from CP's own witness statements that CP does not view the existing operating practices conducted pursuant to the Grain Agreement as a cost effective means of doing business and thus would have an added incentive to reduce service. As noted earlier, KCSR provides the cars. KCSR gives IC&E 75-car unit trains IC&E takes that unit train, breaks it up into different unit sizes, and then delivers those units to up to different origins for loading. Once the cars are loaded IC&E then picks up the cars, reassembles them back into 75 car unit trains, and delivers that unit train back to KCSR for movement to the KCSR feed mills.

Yet, in attempting to refute KCSR's assertions that CP will seek to divert IC&E-originated corn to other destinations, particularly the PNW, Mr. Smith states that "[t]he added cost of gathering cars from multiple country elevators to build unit trains presents a further obstacle to the competitiveness of CPR-UP interline service from the Corn Lines origins to the PNW." (Reply V S Smith at 6) Mr. Anderson also argues the added cost of building unit trains as the reason such Corn Lines traffic will not be diverted away from KCSR destinations (Reply V S Anderson at 6) If, in CP's view, it is too costly and time consuming to build unit trains for corn movements from IC&E elevators to the PNW, then CP will obviously view building such unit trains for movements to KCSR-served feed mills to be just as costly and inefficient As a result, CP will obviously seek ways to eliminate the existing operating practice to make the

Grain Agreement a nullity by downgrading service, in spite of the relatively minor penalties it may incur in doing so

Absent a condition preserving KCSR's ratemaking authority, it is clear that the delivered price of corn to KCSR-served feed mills will rise as a result of the Transaction if those feed mills have to turn to other sources of corn. It is also true that during the remaining term of the Grain Agreement, CP will view the KCSR service as an additional cost that it would rather avoid, and will seek ways to discourage use of the Grain Agreement, most likely by downgrading service and transit times It is important therefore that the STB also impose service or transit guarantees as a condition to any approval of the Transaction

II. THE TRANSACTION WILL REDUCE COMPETITION IN THE LAREDO-KANSAS CITY-CHICAGO CORRIDOR

In KCSR's Comments filed on March 4, 2008, KCSR described DME as an independent regional rail network, and explained how DME's relationship with KCSR and with other connecting carriers has been shaped by this competitive neutrality KCSR also described how the benefits of the DME-KCSR relationship strengthened competition in north south traffic flows, including the ability of the two systems to provide an independent alternative for traffic flows in the Laredo-Kansas City-Chicago corridor. Likewise, KCSR established that due to CP's alliance with UP, CP will eliminate the KCSR routing in the Laredo-Kansas City-Chicago corridor and will either interchange Kansas City-Chicago traffic with UP, and not KCSR, at Kansas City, or will favor its existing CP-UP routings through Minneapolis/St. Paul for NAFTA traffic As such, the Transaction will eliminate one of the few remaining independent routing options for traffic in the Laredo-Kansas City-Chicago corridor. Accordingly, KCSR requested the Board impose a condition making permanent the so-called "Chicago Agreement," which provides terms for the movement of KCSR traffic between Kansas City and Chicago, via the lines of IC&E [21]

The Applicants have objected to KCSR's request for a Chicago Agreement condition by arguing that the (1) the Chicago Agreement is meaningless, (2) that CP has every incentive to continue to work with KCSR to move traffic in the Laredo-Kansas City-Chicago corridor in a post-Transaction environment; and (3) even if the Transaction were to eliminate the KCSR-IC&E route between Laredo and Chicago, there are plenty of alternative routes available. KCSR's rebuttal witnesses demonstrate that CP's close strategic ties with UP (particularly in NAFTA traffic flows) indicate that, absent a condition, CP will not continue to work with KCSR to move traffic in this corridor In fact, when it comes to traffic moving to the U.S.-Mexico gateway at Laredo, CP has previously made clear that UP is CP's interline carrier of choice. As such, there will be a reduction of competition in this corridor as a result of the Transaction unless the Board acts to preserve competition

A. The Existing IC&E-KCSR Relationship In The Laredo-Kansas City-Chicago Corridor Provides An Important Independent Alternative

The essence of the Applicants' argument in response to the potential diminution of competition in the Laredo-Kansas City-Chicago corridor due to the loss of an independent DME is not that rail competition in that corridor won't be reduced, but rather that the Transaction will not reduce competition appreciably because – (1) the Chicago Agreement is not being used, and (2) KCSR and IC&E together participate in little traffic in that corridor These arguments do not

[21] As an alternative approach, KCSR would also accept a condition requiring Applicants and KCSR to negotiate appropriate modifications to the Chicago Agreement so as to provide remunerative rates for both parties, yet maintain the route as a viable independent alternative for traffic in the Laredo-Kansas City-Chicago corridor

accurately reflect the existing IC&E-KCSR relationship in this corridor or the importance of that corridor as a strategic independent route

No one contends that the existing terms of the Chicago Agreement are currently ideal, and no one suggests that KCSR-IC&E traffic is moving pursuant to that agreement, but at the same time, neither party has moved to cancel it. The fact that neither party has forced the issue on the Chicago Agreement by forcing traffic under its terms or by preemptively terminating it reflects the notion that the agreement must have some value. If one understands both the context and the use of the Chicago Haulage Agreement, it is clear that KCSR and DME have been able to develop an effective routing option in the Laredo-Kansas City-Chicago corridor. That option is one which CP likely would not continue, especially given its relationship with UP and its existing use of a CP-UP interchange through the Minneapolis/St. Paul gateway for NAFTA traffic.

Mr Anderson's claim that "IC&E and KCS have had a clear understanding that the IC&E/KCS Chicago Agreement is a 'dead letter'" (Anderson Reply V.S. at 13) is not accurate Indeed, he later states (Anderson Reply V S. at 14), while discussing the need for open gateways, "This commitment ensures that shippers will continue to have the ability to route traffic via DM&E/IC&E-KCS routings following the proposed transaction, regardless of whether the IC&E/KCS Grain Agreement and/or the IC&E/KCS Chicago Haulage Agreement continue beyond their current terms." This latter quote is acknowledgement that the agreement exists and provides a basic framework, from both a price and service standpoint, by which DME and KCSR negotiate joint-line service between the Kansas City gateway and Chicago R V.S Bilovesky at 27.

Mr Anderson is correct that traffic does not move in IC&E-KCSR interline service under the Chicago Agreement and is done under "customary joint rate and divisions arrangements, rather than under the haulage agreement." However, he neglects to inform the Board that such joint rate and divisions arrangement are usually negotiated using the Chicago Haulage Agreement as the basic framework that guides the parties' understandings when developing the "customary joint rate and divisions arrangement" R V.S Bilovesky at 27. The Chicago Haulage Agreement is not simply a "dead letter" as Mr. Anderson claims

Indeed, contrary to Applicants' assertions (particularly those of Mr Williams) that the KCSR-IC&E route is not very important, the KCSR-IC&E route to/from Chicago via the Kansas City gateway is of vital importance to IC&E and KCSR shippers As Exhibit 2 to Mr. Bilovesky's Rebuttal Verified Statement reflects, in 2007, IC&E moved [redacted] southbound cars over its route from Chicago to the interchange with KCSR at Kansas City. Conversely, IC&E received from KCSR [redacted] *northbound cars at the Kansas City gateway for movement to* Chicago. No other joint-line service between KCSR and any other carrier moved more cars between Kansas City and Chicago than the existing IC&E-KCSR relationship.

In KCSR's experience, the interline relationship between KCSR and IC&E that is threatened by the proposed Transaction does matter to shippers who benefit by having competitive alternatives to UP As Boise Cascade has said

> KCSR and IC&E are partners in providing rail transportation between points south of Kansas City to/from Chicago, particularly for NAFTA traffic to/from Laredo and Chicago. Boise Cascade makes use of such KCSR/ICE service. KCSR provides the rail service south of Kansas City, while IC&E participates in the service from Kansas City to Chicago. Boise Cascade regards KCSR-Kansas City-IC&E service to Chicago as an important competitive alternative to Union Pacific Railroad Company's ("UP") service in the same markets As KCSR has pointed out, if Canadian Pacific Railway Company ("CP") is permitted to acquire unconditioned control of IC&E, CP may no longer have an incentive to work with KCSR for Chicago traffic because such service would compete with the same service currently provided by UP and CP, especially for NAFTA traffic via the Chicago gateway. Clearly, such a turn of events would reduce our service options, and undercuts competition in the overall NAFTA corridor.

Boise Cascade, letter to the Board dated March 19, 2008

The fact that KCSR and IC&E currently participate in little Laredo-Chicago NAFTA traffic flows does not mean, as Applicants assert, that the route is unimportant or that there is no reason to grant KCSR's request for a condition tied to the Chicago Agreement. As Dr. Grimm points out, one must examine the market share of the participants in a given market to assess the market structure and therefore the need for preservation of the KCSR-IC&E competitive alternative. R.V.S. Grimm at 8-9 Based upon his analysis, UP has a revenue market share from Laredo to Chicago of over [redacted] From Chicago to Laredo, UP's revenue market share is also over [redacted]. R V.S Grimm at 10. DOJ's threshold for monopolization is generally in the range of a single firm holding 70% or more of the market. UP's market share in these markets is [redacted] Thus, although the KCSR-IC&E routing does not have a large market share, the routing is nonetheless important in maintaining an alternative to UP's dominance in that corridor.

The KCSR-IC&E route between Laredo and Chicago (via Kansas City) can and does serve as a competitive counterbalance to UP's single line service. What is important is that it provides a potential alternative route [22] Indeed, such a route could, in time, become an even more effective counterbalance. This is reason enough for the Board to be concerned over the future role that this service option will play. Here, because the Kansas City-Chicago component of this route could come under the control of a carrier that has expressed only token interest in

[22] The Board previously has observed that even lightly used or unused competitive alternatives to a given service option are nevertheless beneficial See, e g , Southwest Railroad Car Parts Company v. Missouri Pacific Railroad Company, No 40073, slip op at 3 (STB served Feb. 20, 1998) ("We consider potential, as well as actual, competition in determining whether effective alternatives exist. The question is whether an alternative is feasible, not whether it has been used in the past") (footnotes omitted), cf. Major Rail Consolidation, 5 S T B at 617 (promulgating new rules requiring applicants in major and significant transactions to provide a market analysis, including the applicant's marketing plan and "existing and potential competitive alternatives")(emphasis added).

exploring NAFTA opportunities with KCSR,[23] the Board needs to act to preserve the viability of this routing option

B. CP Will Seek To Route NAFTA And Other Traffic Via UP Routings In A Post Transaction Environment

KCSR has argued that due to CP's alliance with UP, CP will eliminate the KCSR routing in the Laredo-Kansas City-Chicago corridor and will either interchange Kansas City-Chicago traffic with UP at Kansas City (discriminating against KCSR) or will favor its existing CP-UP routings through Minneapolis/St. Paul for NAFTA traffic. As such, the Transaction will eliminate one of the few remaining routings options to UP for traffic in the Laredo-Kansas City-Chicago corridor On Reply, the Applicants downplay this and attempt to distance CP from UP CP claims that it will have every incentive to continue to work with KCSR for routings in the Laredo-Kansas City-Chicago corridor and that it will not favor UP routings over KCSR routings

The Applicants insist that KCSR has made no case for the Board to consider the close strategic relationship between CP and UP in this proceeding Applicants strenuously deny the existence of a "multi-faceted" CP-UP "alliance" (despite CP's use of the term "alliance" in its promotional materials) which requires CP and UP to work preferentially with one another. The Applicants further contend that the interline traffic relationship between CP and UP (which is currently manifested in three "Can-Am" service programs) is but one of many allegedly indistinguishable interline relationships that CP has with connecting Class I railroads.

Applicants' claim simply does not comport with the facts As shown in Mr. Woodward's Rebuttal Verified Statement, CP's actions speak louder than words. Specifically, Mr. Woodward's traffic analysis clearly reflects very close ties between CP and UP with respect to

[23] The Applicants claim that CP is initiating a dialogue with KCSR with respect to NAFTA traffic flows via Kansas City. It appears that CP may have made his inquiry solely to make it appear that CP is genuinely interested in such interline traffic opportunities. As Mr Bilovcsky explains, such discussions are a charade See Rebuttal V S Bilovcsky at 30

the manner in which CP chooses to route its interline traffic to points in the western U S. and to Mexico, including in the routing of CP corn traffic to the PNW and NAFTA traffic. The traffic data that Mr. Woodward presents and discusses make abundantly clear that the Can-Am alliance is not merely one of many interline relationships between CP and other carriers; it is in many respects "the" interline relationship. See R.V.S. Woodward at 5-8, Exhibits 1,2, and 3

In their Reply, the Applicants finally offer into evidence copies of the [redacted] and a related [redacted], which underpin the Can-Am alliance.[24] In light of these agreements, Mr. Woodward has analyzed CP-UP interline traffic patterns in comparison with CP's interline traffic flows with other carriers Woodward Exhibit 1 is a graphic depiction of the comparative growth for CP interline traffic with UP, compared against CP interline traffic with all other U S -based Class I carriers between 2001 and 2006 Exhibit 1 shows that CP-UP interline traffic volume is now larger than CP's interline traffic volume with any other U.S. Class I connection It is also noteworthy that the CP-UP volume grew at a [redacted] CAGR[25] compared to a CP-BNSF CAGR growth rate of only [redacted] during the same period. This reflects the uniqueness of CP's preferred relationship with UP and belies Applicants' claim that the Can-Am alliance is really no different than any of CP's other interline relationships.

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[24] It appears that the [redacted] As noted earlier, KCSR sought agreements such as the [redacted] beginning with its first set of discovery requests to CP, but CP has, at different points, declined to provide them and suggested that such agreements did not exist. Under the circumstances, it is hard to believe that the Applicants have been appropriately forthcoming in discovery

[25] "CAGR" = Compounded Annual Growth Rate.

It should be noted that the stated purpose of the [redacted] is to provide [redacted] (Applicants' HC Reply, Exhibit A at A-3), and it would appear from the impressive interline traffic growth between CP and UP that they have achieved that goal. It should also be noted that one of the characteristics of the Can-Am alliance is that "CPR and UP marketing teams work together to solicit business for the three CanAm services" CPR-14 Reply V S Milloy at 4. For marketing purposes, the services offered by CPR and UP in these corridors effectively constitutes the entirety of both railroad's systems. One must question how CP can insist that it has no preferred strategic relationship with UP, when CP expects its marketing teams to work with UP to solicit business that could in many cases be routed in partnership with other railroads. Although CP lists numerous service-enhancing undertakings with interline partners other than UP as evidence that the Can-Am alliance is not "exclusive," never once does CP indicate that those initiatives are accompanied by the joint efforts of both carriers' marketing departments which includes, in part, [redacted] as is the case with the Can-Am alliance and the overarching [redacted]

Mr. Woodward's analysis confirms that the [redacted] is as comprehensive and pervasive as could be possible, given the network structure of the combined CP and UP systems. Under their alliance, CP and UP cooperate in the movement of virtually all traffic (including intermodal traffic which is all routed through Chicago) from virtually every CP-served region of Canada and the U S.[26] Woodward Exhibit 2 shows that the CP-UP [redacted]

[26] CP's Corporate Fact Book for 2006 depicts the CP-UP Alliance as offering a "seamless service" to CP and UP customers, and states that "Joint CPR/UP teams oversee the operations of the Can-Am corridors and make strategic decisions with respect to operations, marketing, technology, and investment" Canadian Pacific Railway 2006 Corporate Profile and Fact Book at 44 (see my original Verifies Statement at 7 n. 6) This statement belies the notion that the Can-Am alliance is merely an initiative designed to accomplish greater interline efficiencies.

[redacted] provide CP and UP with significant and potentially more lucrative long-haul routing options through three specified CP-UP interchange gateways. [redacted] By channeling CP-UP interline traffic through these gateways, CP and UP have concentrated their interline route structure and traffic densities to maximize the benefits of the [redacted] and discourage other competitive routing options R.V S Woodward at 5-6 and Exhibit 2.

Under their alliance, [redacted], extend to shippers and receivers in the U.S. and Canada virtually seamless service between CP-served points and UP-served points as depicted in Exhibit 2. Moreover, because one of the stated purposes of these agreements is to [redacted] one can fairly infer that the CP-UP marketing teams that the Applicants have referred to apply differential pricing techniques to encourage CP-UP traffic routings and to discourage alternative CP and UP routings with other carriers.

Woodward Exhibit 3 illustrates the 2006 interline traffic flows between the CP and UP systems and the specific routes over which CP-UP interline traffic is moving. Particularly noteworthy are the significant CP volumes interchanged to UP at [redacted] Also among the things that Exhibit 3 reveals is that certain CP-UP interline traffic may be subjected to considerable route circuity compared to alternative, more direct interline routes that do not involve CP and UP.

The other operational "co-production" agreements mentioned in the CP Annual Corporate fact book are specific corridors involving largely operational conveniences (such as the CP-NS and CP-CN arrangements for specific corridors and interchanges) No agreement that CP has described provides for such a comprehensive commercial and operating agreement as the CP-UP alliance

UP is by far the dominant rail carrier moving traffic between Laredo and Chicago, and the Can-Am alliance contributes to that dominance by specifically contemplating the movement of traffic between CP-served points [redacted] Although CP has other interline choices for routing traffic to and from Laredo, CP has come to view UP's NAFTA service as CP's primary means of access to Mexico, and it has said so publicly CP has stated that "nearly 90 percent of the rail traffic to and from Mexico in which CPR participates moves via Laredo (virtually all in conjunction with UP...)," and it has also expressed concern that KCSR's "NAFTA Rail system" could potentially impair the "competing services offered by CPR and others (in conjunction with UP)" via the Laredo gateway CP Comments (September 2, 2003) and Additional Comments (September 30, 2004) filed in connection with Kansas City Southern – Control – The Kansas City Southern Railway Company, Gateway Eastern Railway Company, and The Texas Mexican Railway Company, STB Finance Docket No. 34342.

To demonstrate the extent to which CP and UP cooperate on NAFTA traffic flows through [redacted], Mr Woodward offers Exhibit 11 Exhibit 11 confirms the close partnership between CP and UP in this service lane, and reflects the far more limited extent to which CP traffic flows to and from Mexico rely on carriers other than UP.[27] In fact, the CP-UP alliance simply increases the gathering and distribution traffic network to feed UP's dominant NAFTA

[27] The Applicants state that Canadian National Railway ("CN") participates in more NAFTA traffic flows through Chicago than does CP, by which they hope to mislead the STB about the importance of CP-UP NAFTA traffic volumes Consulting a rail network map shows that CP and UP enjoy a very direct route between CP-served points in the western Canadian provinces of Saskatchewan and Manitoba and the U.S. states of North Dakota and Minnesota and UP-served Mexican gateways via an interchange at Minneapolis-St. Paul [redacted] CN does not enjoy such an efficient connection with UP at the Twin Cities, and so, it would appear that CN and UP find it more efficient to interchange traffic to [redacted] instead.

system. In effect, CP and UP are in fact "two railroads acting as one" as a UP marketing official has characterized the relationship

Mr. Woodward's and Dr. Grimm's analysis show that UP is the dominant carrier in Laredo-Chicago traffic movements Mr. Woodward's analysis shows that CP is a willing participant in this dominance by routing its NAFTA traffic to and from Mexico via UP interchanges as prescribed under the [redacted] CP and UP both recognize the value of their respective shares of the NAFTA market and price traffic accordingly R V.S. Woodward at 30, Exhibit 12.

Because UP holds the dominant position in the Chicago-Laredo NAFTA corridor and CP and UP have a strategic alliance, CP is unlikely to develop a strong cooperative relationship with KCSR to develop attractive alternatives to UP's Laredo-Chicago service Neither will CP use the IC&E line from Chicago to Kansas City to continue to work with KCSR, as doing so would undercut the advantages that CP enjoys in its partnership with UP and in some cases might actually be a breach of the [redacted]

Given CP's agreements with UP, it is no surprise then that when KCSR, knowing DME's previous displeasure about the divisions and other terms contained in the Chicago Agreement, recently proposed a substantial modification to (or a substitute for) the Chicago Agreement that would be mutually beneficial to both parties, it was CP, and not DME, who first wrote a letter saying that it saw no reason to work with KCSR to modify the Chicago Agreement Indeed, were it not for the intervening event of this Application, and CP's obvious lack of interest in exploring alternatives to the Chicago Agreement, a substitute for that agreement may already have been in the works See R.V.S. Bilovesky at 29-30 CP clearly does not view the IC&E route from Kansas City-to Chicago as an important part in any NAFTA traffic flows, at least not with KCSR.

In the end, Applicants do not dispute that KCSR and IC&E can offer shippers an alternative to UP's service in the Laredo-Kansas City-Chicago corridor, nor do they contest the potential of an aggressive joint effort by KCSR and IC&E and its possible impact on NAFTA traffic flows. Rather than admit to the prospect that KCSR and IC&E could move beyond the Chicago Agreement to find a better mechanism to compete in north-south traffic flows, the Applicants simply suggest that, although competition may be reduced in the Laredo-Kansas City-Chicago corridor, this is nothing to be worried about. Nothing could be further from the truth Where competition is reduced, this Board should impose appropriate conditions to prevent that from happening. An appropriate remedy is to require CP to keep the Chicago Agreement in place permanently. Alternatively, to address DME's previous concerns over the rate arrangements and the concerns of KCSR and its shippers, CP and KCSR can, under Board supervision, negotiate modifications to that agreement to allow for the movement of all traffic under reasonable terms for both parties.

C. <u>Absent A Condition, UP Will Continue To Monopolize Traffic In This Corridor</u>

As part of its efforts to downplay the importance of the Laredo-Kansas City-Chicago KCSR-IC&E routing, Applicants maintain that even if CP does not work with KCSR to route NAFTA traffic in a post-Transaction environment, there are so many other routing alternatives in this corridor that competition would not be reduced. The view of CP is that there is ample competition in the Chicago-Laredo corridor, and therefore no need to preserve the competitive option provided by the KCSR rights to Chicago over the IC&E CP bases this on the number of physical routings· "NAFTA traffic that could potentially move via a Chicago-Laredo route actually moved in 2005 over a total of 32 different single line and interline rail routes." (CPR-14 at 36). Indeed, during the Grimm deposition, attorneys for CP engaged in a laborious exercise of delineating, with a railroad map, all of the various railroad routings for Chicago-Mexico traffic (Grimm deposition, pp 137-144). There are several fallacies in CP's argument.

First, CP's statements regarding the number of rail routings goes beyond the Chicago-Laredo corridor and includes other Mexican gateways The ICC and STB have long recognized that Laredo is the premiere Mexican gateway This conclusion is based on many factors, including more efficient routings and strong infrastructure support, including customs and ancillary services Union Pacific/Southern Pacific Merger, 1 S.T.B 233, 1996 STB LEXIS 220 at *421-426 (1996)("UP/SP").

Second, while there are literally dozens of alternative routes in this corridor, the Applicants have ignored whether those routings are truly independent routings, (i e, whether these routes actually compete against each other) It has long been a basic tenet of rail competitive analysis that competition is greatly enhanced when alternative, *fully*-independent routings are available R V.S Grimm at 9. If one firm participates on all routings, competition can be greatly hampered. This view, that independence of routings is critical, was clearly stated many years ago by the ICC:

> Competition between railroads generally requires the presence of two or more independent routes, that is, routes having no carriers in common. When a single carrier is a necessary participant in all available routes, i e a bottleneck carrier, it can usually control the overall rate sufficiently to preclude effective competition

Consolidated Papers, Inc., et al v Chicago and North Western Transportation Co , et al, 7 I C C 2d 330, 338 (1991) In this case, only two railroads have lines serving Laredo, UP and KCSR. Thus, any traffic moving between Chicago and Laredo must be interlined with either UP or KCSR. As such, there are only two independent routings in the Laredo-Kansas City-Chicago corridor See R.V.S Grimm at 9 and R.V.S. Bilovesky at 28. Applicants have not shown that

KCSR could interline with carriers other than IC&E and that such routings would be as competitive or as efficient in moving traffic to Chicago as the existing KCSR/IC&E relationship

Finally, and most importantly, CP does not apply the basic principles of market structure analysis in determining the extent to which other alternative routes compete against each other In doing so, one must examine the market share of the participants in the market to assess the market structure and to determine the need for preservation of the KCSR/IC&E competitive alternative R.V.S. Grimm at 9-10. As noted, because any routing competing with a IC&E-KCSR routing would involve UP, one must examine UP's market share to determine the extent to which there is competition in the corridor.

To provide data on market share and market concentration, Dr Grimm analyzed the railroad traffic between Laredo, TX and Chicago from the STB's 2005 Waybill Sample For traffic from Laredo to Chicago (R.V.S. Grimm, Table 1), he used all traffic which showed Laredo either as the origin or a junction point and was destined to BEA 64 (Chicago-Gary-Kenosha, IL-IN-WI) or showed Chicago as the junction point. For traffic from Chicago to Laredo (R.V.S. Grimm, Table 2), he used all traffic to Laredo which showed BEA 64 as the origin or a junction point He reached several conclusions. First, the data in Grimm Tables 1 and 2 clearly reveal that there are only two independent alternatives in this market, UP and KCSR Second, the market share data present a powerful picture of UP dominance in this corridor, and underscore the need for preservation and strengthening of the KCSR-IC&E competitive option Based on the 2005 waybill data, UP has a revenue market share from Laredo to Chicago of over [redacted] From Chicago to Laredo, UP's revenue market share is also over [redacted]

The U.S. Department of Justice's threshold for monopolization is generally in the range of a single firm holding 70% or more of the market. R.V.S. Grimm at 10. By any standard, UP monopolizes the rail market in both directions between Chicago and Laredo. Although the KCSR-ICE routing does not have a large market share and is dwarfed by UP's dominance, the KCSR-ICE routing is nonetheless important in maintaining an alternative to UP's dominance in that corridor. R.V.S. Grimm at 10; R V S Woodward at 33-34

The STB has long recognized the need to maintain a competitive balance to UP for NAFTA traffic flows, and provided The Texas Mexican Railway Company trackage rights in the UP/SP proceeding to connect with KCSR to provide an independent alternative to the UP monopoly <u>UP/SP</u> at * 424 (1996) The STB should continue its efforts to preserve and strengthen competitive alternatives to UP in the Chicago-Laredo corridor and should not approve the Transaction without at least ensuring that KCSR's ability to compete in this corridor remains

In the end, KCSR's witnesses – Mr. Bilovesky, Dr Grimm, and Mr Woodward – all reinforce the important role that the KCSR-DME relationship plays in providing a competitive service alternative to shippers in the Laredo-Chicago NAFTA corridor. The importance of that service alternative must not be overlooked, especially in a rail service corridor so heavily dominated by UP (a dominance to which CP contributes by routing the vast majority of its traffic in this corridor via UP). The key to the importance of this service alternative lies in its potential, not its actual use. The simple fact is that granting the Application without appropriate conditions will result in UP's continued and increased dominance in this service corridor. KCSR's request for a condition tied to the Chicago Agreement is a most effective way to avoid such a result

III. THE APPLICANTS' "OPEN GATEWAY" PLEDGE DOES NOT ADEQUATELY ADDRESS THE ADVERSE IMPACTS OF THE TRANSACTION

In the previous sections, KCSR has established that an unconditioned Transaction threatens serious adverse impacts to corn shippers and receivers and to competition in rail freight service in the Laredo-Kansas City-Chicago corridor. KCSR has also proven that such adverse impacts require specific, narrowly-tailored ameliorative conditions tied to existing KCSR-DME agreements The Applicants, however, stubbornly insist, based on an incomplete competitive analysis, that no such adverse impacts will occur, or, in the alternative, that if they are to occur, the harms to shippers and to competition will be very small The Applicants cling to this position despite the fact that shippers who are actually impacted by the Transaction – Boise Cascade, OK Industries, Tyson Foods, J.W. Nutt Company, the Southern Minnesota and Northern Iowa Shippers Association, and MFA Incorporated, for example – have themselves voiced the concerns that KCSR has presented

The Applicants' position also contrasts with the view of the United States Department of Agriculture ("USDA") USDA understood the need to maintain DME's neutrality and KCSR's ability to connect with a merged CP/DME system on a neutral basis It stated that.

> USDA requests that the Board condition this acquisition with the requirement to maintain cost-competitive and non-discriminatory connections to other railroads. The basis for this request is the importance of preserving rail-to-rail competition

Upon reviewing the March 4 comments, USDA filed reply comments on April 18 which further explained USDA's concerns and comments. It stated:

> Another example of the principle expressed in our March 4 comments is the existing agreements between Kansas City Southern Railways (KCS) and the DM&E system. USDA requests that the Board condition its approval of the CP purchase of DM&E with the requirement that cost-competitive and non-discriminatory connections be maintained with KCS as well. USDA contends that it is in the public interest to preserve the neutrality of the DM&E system which would preserve the ability of shippers to choose the markets in which they sell their products and the rail carrier

In the face of such concerns, the Applicants grudgingly have offered for the first time in their Reply a generic "open gateway" pledge that they claim adequately addresses KCSR's concerns and those of the shippers who share KCSR's concerns Although the Applicants depict this pledge as a significant concession, the pledge falls short of the series of commitments that have become customary in transactions presented under the Board's formal application process In recent years, merger applicants typically have committed to do the following. (1) maintain "open gateways" (to address questions of possible vertical foreclosure), (2) maintain contract commitments (under which applicants promise not to modify or cancel contracts with shippers or other carriers), (3) adhere to a bottleneck waiver pledge; and (4) submit to periodic post-transaction reporting and Board monitoring. Such commitments have been commonplace even in the case of applications for transactions that have been deemed "minor" under the Board's merger rules [28] Aside from its generic open gateway commitment, and notwithstanding that this Transaction has been deemed "significant," CP has made none of the standard other pledges enumerated above. At a minimum, the Board should impose them as it has done in every recent minor transaction

There are several other problems with the open gateway commitment. The CP pledge is extremely vague. The phrase "affected gateways" is not defined. It is not consistent with the Ag Processing's or SMNISA's views of the CP pledge, both of which believe the pledge specifically means Kansas City and Chicago. Does the pledge mean Kansas City and Chicago? If so, CP should say so, and at a minimum, the Board should make clear that Kansas City and Chicago are "affected gateways" governed by the pledge The phrase "commercially reasonable terms" is also not defined. Likewise, the commitment says nothing about car supply, transit times, and

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[28] Examples of minor transactions involving all or a combination of these four commitments include Canadian National Railway Company and Grand Trunk Corporation – Control – EJ&E West Company, STB Finance Docket No. 35087 (pending); Kansas City Southern – Control – The Kansas City Southern Railway Company, Gateway Eastern Railway Company, and The Texas Mexican Railway Company, __ S.T.B __, STB Finance Docket No 34342 (STB served Nov 29, 2004); Canadian National Railway Company and Grand Trunk Corporation – Control – Duluth, Missabe & Iron Range Railway Company, Bessemer and Lake Erie Railroad Company, and The Pittsburgh & Conneaut Dock Company, __ S.T.B. __, STB Finance Docket No 34424 (STB served Apr 9, 2004), and Canadian National, et al. – Control – Wisconsin Central Transp Corp., et al., 5 S T.B. 890, 901 (2001)

service standards, which are crucially important to the shippers and receivers of IC&E-originated grain.

Whether Applicants' will maintain an adequate car supply for IC&E-originated grain in a post-Transaction environment remains unresolved by Applicants' open gateway commitment When CP previously owned the IC&E lines, CP gained a reputation for failing to maintain the line or provide adequate car supply. R V S Bilovesky at 16. In fact, due to this history, USDA specifically, noted at page 3 of its March 4 comments, that·

> Some IC&E shippers also are concerned about adequate grain car supply. These shippers have stated that CP did not provide an adequate supply of grain cars when it operated the current IC&E lines. Thus, USDA requests that the Board encourage CP to maintain the number of grain cars available to agricultural shippers on the DM&E system at the levels provided during 2007 and that CP not favor Canadian shippers over those from the U S.

USDA reiterated this concern in its April 18 Reply Comments when it stated·

> USDA also requests that the Board consider conditioning this application with the requirement that CP maintain the number of grain cars available to agricultural shippers on the DM&E system at the levels provided during 2007 without reducing the supply available to North Dakota shippers. In addition, USDA reaffirms its request that CP not favor Canadian shippers over those from the U.S

The "open gateway" commitment does nothing to resolve USDA's request that the "Board condition its approval of the CP purchase of DM&E with the requirement that cost-competitive and non-discriminatory connections be maintained with KCS as well " USDA April 18 Comments at 3. The open gateway commitment does not, post-Transaction, require CP to provide cars, does not require them to treat KCSR in a non-discriminatory manner at the Kansas City gateway vis-à-vis UP, and does nothing to guarantee service standards and transit times. On the other hand, making sure that KCSR's Grain Agreement is extended or made permanent would provide a readily available source of car supply (i.e., KCSR already has the cars). It would maintain the existing operating practices of allowing elevators that do not have 75 or 100 car loading capacity to nonetheless ship in unit train service, and gives the Corn Lines grain elevators the choice to ship their grain via the KCSR to the poultry markets in the south-central U S or to CP-served destinations in the PNW, Great Lakes, Chicago, or for Canadian domestic use.

Likewise, the Board needs to consider the Applicants' open gateway pledge in the context of the longstanding CP-UP relationship. While the open gateway commitment would require CP to quote a commercially reasonable rate for KCSR interline service between Chicago and Kansas City over the (then former) IC&E line, such a commitment does not guarantee service, car supply, or that the rate quoted KCSR would not be discriminatory vis-à-vis CP-UP interchanges at Chicago or Kansas City As previously noted, to the extent that CP does intend to use the Kansas City gateway [redacted][29], then CP will have every incentive to interchange that traffic at Kansas City with UP, rather than with KCSR, and to price differentially to allow that to happen R V S Bilovesky at __. Nowhere in the legal comments or witness statements in CPR-14/DME-14 does CP commit that it will continue to interchange with KCSR at Kansas City or that it would not favor UP interchange vis-à-vis KCSR It simply commits to quoting rates to/from the Kansas City gateway.

The simple truth is that the CP "open gateway" commitment is too vague and undefined to resolve the competitive concerns that CP itself now admits exists and have been expressed by the grain elevators, the grain receivers, and the USDA Without further action by this Board, the commitment does not resolve concerns over service, car supply, or maintain the neutrality of the existing DME system, which currently allows the shipper and the market, not the linehaul

[29] CPR-14/DME-14, HC Version, Appendix, Vol 2, Tab. I.

carrier, to choose where shipments move The appropriate fix to the competitive concerns is to adopt the conditions as requested by KCSR

IV. THE APPLICANTS HAVE NOT SHOWN THAT CONDITIONS ARE UNWARRANTED

Although the Applicants have proposed the first transaction deemed "significant" since passage of the ICC Termination Act of 1995, the Applicants nevertheless have been reluctant to provide – and indeed they have not provided – a rigorous evaluation of the competitive consequences of the proposed Transaction. Instead, Applicants have presented a narrow competitive analysis focusing only on specific points and stations, and even then, relied upon data from only one year to reach their conclusions. They have ignored or have purposely avoided the more sophisticated and comprehensive market structure approaches[30] commonly used by the Department of Justice, Federal Trade Commission, and by applicants in other proceedings before the Board, including proceedings that have been deemed "minor" transactions. See R.V.S. Grimm at 7-8, Kansas City Southern – Control – The Kansas City Southern Railway Company, Gateway Eastern Railway Company, and The Texas Mexican Railway Company, STB Finance Docket No. 34342 (application filed May 13, 2003) ("KCS/NAFTA") at 73-82;[31] Canadian National Railway Company, Grand Trunk Corporation, and WC Merger Sub, Inc. – Control – Wisconsin Central Transportation Corporation, Wisconsin Central Ltd., Fox Valley & Western Ltd., Sault Ste Marie Bridge Company, and Wisconsin

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[30] One such market structure approach is to analyze the transaction's impact on independent rail routings between two origins and destinations, such as a BEA-to-BEA corridor. Another approach is to analyze market concentration in accordance with the U.S. DOJ's Horizontal Merger Guidelines Such market structure approaches have been commonly employed by the U S Department of Justice and other agencies.

[31] In the KCS/NAFTA application, KCSR noted that the BEA-to-BEA analysis it undertook adhered to the methodology employed by the U.S Department of Justice in Santa Fe Southern Pacific Corp – Control – SPT Co , 2 I C.C 2d 709 (1986), 3 I C C 2d 926 (1987).

Chicago Link, STB Finance Docket No. 34000 (application filed April 9, 2001) ("CN/WC") at 175-256; Kansas City Southern Industries, Inc., KCS Transportation Company and The Kansas City Southern Railway Company – Control – Gateway Western Railway Company and Gateway Eastern Railway Company, STB Finance Docket No 33311 (application filed January 14, 1997) at 121-137.

Rather than undertake on Reply the sort of competitive analysis that KCSR and its expert witness, Dr Grimm, have pointed out is lacking in the Application, the Applicants have attempted to shift the burden to KCSR Applicants' position appears to be that it is KCSR's burden to show competitive harm, not the Applicants' burden to prove the lack of competitive harm. Indeed, they have attacked Dr. Grimm for not coming forth with a comprehensive market structure competitive analysis to show that there is harm [32] This flips the statute on its head. Under 49 U.S C § 11324(d), the Board shall approve a transaction, such as the one proposed by the Applicants, unless it finds that –

> (1) as a result of the transaction, there is likely to be substantial lessening of competition, creation of a monopoly, or restraint of trade in freight surface transportation in any region of the United States, and
> (2) the anticompetitive effects of the transaction outweigh the public interest in meeting significant transportation needs

In light of the applicable standard, the Board's rules and practice contemplate that the Applicants must offer a sufficiently-developed case to support Board approval of the Application. See 49 CFR 1180 4(c)(8), see also, e.g., CSX Corporation and CSX Transportation, Inc., Norfolk Southern Corporation and Norfolk Southern Railway Company – Control and

[32] In his original verified statement, Dr. Grimm presented a few examples, using a market structure approach, of the type of horizontal competitive harm that Applicants' Application had failed to address. In his Rebuttal Verified Statement, Dr Grimm further explains why a market structure approach is appropriate and how Applicants have failed to provide such an analysis R V S Grimm at 3-6.

Operating Leases/Agreements – Conrail Inc and Consolidated Rail Corporation, STB Finance Docket No. 33388 (STB served Jul. 29, 1997), Union Pacific Corp , et al – Control – CNW, 9 I C.C 2d 939, ___(1993), 1993 ICC LEXIS 183, *21-22. Moreover, as a fundamental premise of administrative law, the party proposing specific agency action (in this case, the Applicants, who seek approval of a railroad transaction subject to the Board's jurisdiction) bears the burden of proof to show that the requested agency action is warranted. See 5 U S.C § 556(d) ("[e]xcept as otherwise provided by statute, the proponent of a rule or order has the burden of proof").[33] Beyond the general burden of proof requirements of the APA, the Board's rules governing applications for approval of significant transactions are quite specific about the scope of market and competition impact analysis that must be undertaken for the Board to make its findings under Section 11324(d). See 49 CFR 1180.0(a) and 1180.7(a)

As with any railroad control proceeding, but especially one involving a transaction that the Board has deemed significant under its rules and is thus subject to the approval standards at Section 11324(d), the Applicants should supply detailed evidence to satisfy the Board's competitive impact analysis. They have not, and notwithstanding that the burden of proof falls on Applicants, KCSR has provided substantial evidence of competitive harm in at least two markets: IC&E-KCSR routings to the poultry markets in the south-central U S and rail traffic in the Laredo-Kansas City-Chicago corridor. As such, the Applicants again have the burden of proof to show that the Transaction will not result in a substantial lessening of competition in

[33] The Board has cited and relied upon this burden of proof requirement set forth in the Administrative Procedure Act ("APA"). See, e.g., Michael H Meyer, Trustee in Bankruptcy for California Western Railroad, Inc v North Coast Railroad Authority, d/b/a Northwestern Pacific Railroad, STB Finance Docket No 34337 (STB served Jan. 31, 2007), slip op. at 4 n. 5; Union Pacific Railroad Company – Abandonment Exemption – In Rio Grande and Mineral Counties, CO, STB Docket No. AB-33 (Sub-No. 132X) (STB served Jun 22, 2004), slip op. at 8, Dardanelle & Russellville Railroad Company – Trackage Rights Compensation – Arkansas Midland Railroad Company, 1996 STB LEXIS 232, *3 (STB served Sept 5, 1996).

those markets This burden is even more acute where, as here, KCSR has demonstrated the Transaction's potential for significant anticompetitive impacts absent appropriate conditions. See, e.g., CSX Corporation and CSX Transportation, Inc. – The Indiana Rail Road Company, STB Finance Docket No. 32892 (STB served Nov 7, 1996), 1996 STB LEXIS 280, *9 ("[a]pplicants have demonstrated to our satisfaction that the potential impact of the proposed transaction should not be significant"); Kansas City Southern Industries, Inc., The Kansas City Southern Railway Company and K&M Newco, Inc. – Control – MidSouth Corporation, MidSouth Rail Corporation, MidLouisiana Rail Corporation, SouthRail Corporation and TennRail Corporation, Finance Docket No 32167 (ICC served Nov 8, 1994), 1994 ICC LEXIS 217, *4 ("applicants' initial evidence was not as complete as might be necessary in view of the ... opposition") As has been shown, the Applicants have not proven that the adverse impacts of the Transaction that KCSR has established in its Comments and this Rebuttal will not occur, nor have they provided any concrete assurances to protect against those harms.

CONCLUSION

KCSR does not object to the proposed Transaction, provided that the Board imposes appropriate conditions to preserve the current routing options available to Corn Line shippers and receivers in the south-central U.S. and the ability of shippers to use an independent routing in the Laredo-Kansas City-Chicago corridor. The Applicants object to such conditions, insisting that the Transaction will not result in any competitive harm. But the Applicants have failed to make a persuasive case of no competitive impact under the applicable standard at 49 U.S C § 11324(d), and only grudgingly allow that there may be impacts of the Transaction that warrant the "remedy" of a generic and vague open gateway pledge In contrast, the attached Rebuttal Verified Statements of Mr Bilovesky, Dr Grimm, and Mr Woodward confirm that the Transaction threatens specific anticompetitive impacts.

KCSR's evidence on rebuttal once again confirms that KCSR-served domestic receivers of corn, who depend heavily upon access to IC&E grain by way of the Grain Agreement, will face the loss of access to such grain because this corn is very likely to be diverted to PNW export markets, forcing the buyers of this corn to obtain it from alternative sources at much higher prices Likewise, KCSR's rebuttal evidence reinforces the point that the Transaction will affect the competitive landscape in a critical NAFTA corridor. KCSR's ability to serve as a counterbalance to UP's dominance in the Chicago-Kansas City-Laredo corridor will be weakened even further in light of CP's alliances and contracts with UP, which monopolizes this market.

As KCSR has made clear, the protective conditions it seeks in this proceeding are directly tied to the demonstrated harms of the Transaction, which KCSR has – despite Applicants' flawed evidence and argument to the contrary – proven are very likely to occur Applicants, who bear the burden to prove that the Transaction will not result in a substantial lessening of competition, have not met that burden with respect to the competitive harms highlighted by KCSR. For all of the reasons set forth above, KCSR urges the Board to grant the Application subject to the conditions requested by KCSR

Respectfully submitted,

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Attorneys for The Kansas City Southern Railway Company

Dated: May 19, 2008

CERTIFICATE OF SERVICE

I have this day served a copy of the foregoing Rebuttal Of The Kansas City Southern Railway Company In Support Of Its Request For Conditions upon all parties of record by depositing a copy in the U.S. mail in a properly addressed envelope with adequate first-class postage thereon prepaid, or by other, more expeditious means

Dated· May 19, 2008

William A. Mullins
Attorney for The Kansas City Southern
Railway Company

Bilovesky

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

FINANCE DOCKET. NO. 35081

CANADIAN PACIFIC RAILWAY COMPANY, ET AL.

– CONTROL –

DAKOTA, MINNESOTA & EASTERN RAILROAD CORP., ET AL.

COMMENTS OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY AND REQUEST FOR CONDITIONS

EXHIBIT A

REBUTTAL VERIFIED STATEMENT OF MICHAEL R. BILOVESKY

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

FINANCE DOCKET. NO. 35081

CANADIAN PACIFIC RAILWAY COMPANY, ET AL.

- CONTROL -

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COMMENTS OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY AND REQUEST FOR CONDITIONS

REBUTTAL VERIFIED STATEMENT OF MICHAEL R. BILOVESKY

My name is Michael R. Bilovesky. I am Vice President, Sales and Marketing-Agriculture and Minerals Business Unit of The Kansas City Southern Railway Company ("KCSR").[1] I previously provided a verified statement in this proceeding that was included as Exhibit A in KCSR's March 4 filing (KCSR-2). The primary purpose of my previous statement was to address the anticompetitive effects that the proposed Transaction would have on the feed mills that currently utilize an IC&E-KCSR grain agreement to ship grain (corn) from IC&E origins to KCSR-served feed mills that provide feed to the poultry markets in the south-central United States.

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[1] In this statement, I will use the following acronyms and terms: Canadian Pacific Railway Company ("CP"); Dakota, Minnesota & Eastern Railroad Corporation ("DM&E"); and Iowa, Chicago & Eastern Railroad Corporation ("IC&E"). (Collectively, CP, DME, & IC&E are "Applicants") I will also refer to DM&E and IC&E, collectively, as "DME," just as was done in the Application.

As I previously established, unless the STB adopts KCSR's proposed condition with respect to the Grain Agreement, the grain elevators served by IC&E, primarily on the so-called "Corn Lines," are likely to see a loss of market opportunities as CP will seek to divert that grain and eliminate the current routing option to KCSR destinations in the south-central poultry markets. Likewise, I established that the feed mills that depend upon this IC&E originated grain would then have to seek other sources of grain, but in doing so, would have to pay substantially more for that grain because IC&E originated grain represents the lowest cost grain on a delivered cost basis. Retaining KCSR pricing authority for grain originated on the Corn Lines and implementing service standards and monitoring during the remaining term of the Grain Agreement would ensure that the Transaction did not result in economic harm to the grain elevators or feed mills.

In reply to KCSR's arguments, Applicants' point to the statements of shippers and shipper associations, including groups representing Corn Line elevators, as evidence that the corn shippers do not share KCSR's concerns. Applicants' reply witnesses, primarily Mr. Lynn Anderson, Mr. Don Smith, and Mr. John Williams, have all attacked my conclusions. They argue that the feed mills are not dependent upon IC&E grain and have plenty of other sources of corn available to them and at comparable prices and terms of service. They also argue that CP would not seek to divert IC&E originated corn on the Corn Lines to PNW routings because to do so is not in CP's economic best interests and the length of haul would be too circuitous. Finally, they downplay the importance of the Chicago Haulage Agreement, minimize the impact of the existing KCSR-IC&E routing arrangement in the Laredo-Kansas City-Chicago corridor, and claim the Transaction will not result in a lessening of competition in that market.

Applicants' reply evidence with respect to the competitive impact of the Transaction on the shippers and receivers who use the existing Grain Agreement or the KCSR-IC&E routings in the Laredo-Kansas City-Chicago corridor does not accurately reflect the adverse competitive impacts that flow from the Transaction. In this rebuttal statement, I will address why the Transaction is in fact harmful to the KCSR-served feed mills in the south-central U.S. poultry markets, contrary to Applicants' reply arguments; explain why the open gateway commitment does not resolve that harm; explain why KCSR's suggested condition is the best way to preserve the competitive status quo; and address Applicants' arguments regarding the competitive importance of maintaining the existing KCSR-IC&E routings in the Laredo-Kansas City-Chicago corridor.

I. THE TRANSACTION WILL RESULT IN COMPETITIVE HARM TO BOTH SHIPPERS AND RECEIVERS WHO DEPEND UPON THE EXISTING GRAIN AGREEMENT

A. KCSR-Served Feed Mills Do Depend Upon IC&E-Originated Corn; Buying From Alternative Origins Will Result In Economic Harm

Applicants make much of the fact that many shippers and shipper organizations support the Transaction. I have never disputed that the Transaction will bring benefits to some agricultural shippers. Indeed, it does not surprise me that DME shippers located in South Dakota and northern Minnesota, such as CHS, the largest farmer-owned cooperative in the U.S., Dakota Mill & Grain, Inc., or the South Dakota Corn Growers Association, all of whom ship to the PNW, the Great Lakes, or to local ethanol plants, would support the transaction. The Transaction would likely benefit these shippers by providing them with single-line access to some of their existing markets or expanding the number of markets that can be reached on a single-line basis. However, there are other shippers and receivers who will not enjoy the benefits of the Transaction. For some grain elevators on IC&E's line and the buyers of that corn - i.e., the feed mills in the south-central U.S. - the Transaction will result in economic harm through reduced market access. It is the concerns of these shippers and buyers that prompted KCSR's involvement in this proceeding.

Applicants have attempted to resolve these concerns through their "open gateway" commitment, which the Board, at a minimum, should impose as a condition. While this commitment has formed the basis of a settlement agreement with the Corn Line shippers, Applicants offer no similar assurances to the feed-mills who actually buy the IC&E-originated corn and who pay the transportation costs. In other words, those who actually pay the rail rates and who will be directly harmed due to the loss of DME's neutrality have no settlement agreements or assurances that they will not end up paying more for their corn.

The concerns of these receivers are real concerns. The harms to them are not insignificant, as Mr. Williams' simple and formulaic approach of looking at railroad market shares of corn originations from the 2005 STB Waybill Sample implies. The harms that these individual KCSR-served feed mills would suffer cannot be minimized, as Mr. Williams' "number-crunching" attempts to do, by looking at <u>all</u> corn terminations (regardless of origin) from <u>all</u> railroads to <u>all</u> feed mills in the various states in which the KCSR feed mills are located to downplay the significance of IC&E-originated corn. Instead, only by examining the impacts on the real buyers of corn, those served by KCSR and most of whom, receive the majority of their corn needs from the Corn Lines, can one determine the adverse impacts caused by the Transaction.[2]

[2] CP and DME combined may not control a large percentage of all corn originations when compared to other railroads, as noted by Mr. Williams in his verified statement (Reply V.S. Williams at 3-6), but this is of no solace to a feed mill that depends upon IC&E-originated corn for virtually all its rail delivered corn needs, as some of the KCSR-served feed mills do. The fact that there may be other railroads that that deliver corn to other feed mills in that same state, or

Exhibit 1 attached hereto is a list of every receiver where KCSR terminates corn, including the feed mills at issue here (* denotes a feed mill). All of these feed mills are served by KCSR. This list (minus the *)[3] is publicly available on the KCSR website. Mr. Williams and others could have easily reviewed it and compared it with KCSR's 100% traffic data (which KCSR supplied) to see that, contrary to Mr. Williams' analysis based solely on the 2005 Carload Waybill Sample (Reply V.S. Williams at 15-17), KCSR does in fact serve feed mills in the states of Alabama, Arkansas, Oklahoma, Louisiana, Mississippi, and Texas. Indeed, KCSR has, in the 2005-2007 period, delivered IC&E corn to the KCSR-served feed mills in all of those states except for the state of Alabama, Mr. Williams' conclusions notwithstanding.

For many of the KCSR-served receivers, IC&E-originated corn is the largest single source of corn. Mr. Williams attempts to minimize the role KCSR plays by looking at KCSR's market share of <u>all</u> corn deliveries from <u>all</u> railroads to the entire state where a particular KCSR-served feed mill is located. He does so only with 2005 data from the Waybill Sample. Mr. Williams' analysis is both faulty and incomplete. For example, Mr. Williams claims that "<u>IC&E originated corn accounted for only [redacted] of the corn delivered by rail to the states of Arkansas and Oklahoma in 2005</u>." (Williams Reply V.S. at 17)(emphasis in original). He then concludes that any "suggestion that feed mills in Arkansas and Oklahoma are 'dependent' on IC&E origins for their corn" is not supported by the data.

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that, in theory, could interchange their corn to KCSR for delivery to the KCSR served feed mills, does not establish that "alternative sources of corn" cost less, on a delivered price basis, than the IC&E-KCSR corn does today. The bottom line is that for a significant number of our feed mills, IC&E originated corn represents the lowest price corn, and if the Transaction requires such a feed mill to obtain corn from another source, which it could likely do, it would have to pay more for that alternative sourced corn. As a result, that feed mill would be economically harmed as a result of the Transaction.

[3] "YC" denotes that yellow corn is delivered at that station.

This analysis misses the point. IC&E originated corn may have only accounted for [redacted] of all rail delivered corn to the entire states of Arkansas and Oklahoma in 2005 (Williams includes corn delivered from all other origins from all other railroads to derive his [redacted] figure), but for the specific feed mills in those states that are served by KCSR, IC&E originated corn accounted for almost [redacted] of their rail delivered corn for 2006 and 2007.[4] Thus, it is true that not all feed mills in Arkansas and Oklahoma (or other states for that matter) are dependent upon IC&E originated corn, but most of the KCSR-served feed mills in those states certainly are. It is these receivers who pay the rail freight, who have expressed concern about this proceeding, and on whose behalf KCSR is participating in this proceeding.

It doesn't matter if other carriers, such as UP, BNSF, CN, and NS, deliver a larger percentage than KCSR of the total rail delivered corn to a particular south-central U.S. state where a KCSR-served feed mill is located. Those other carriers are delivering corn that is delivered to the feed mills that they serve. These other feed mills are, in most cases, in competition with the KCSR-served feed mills in those very same states. What matters to the KCSR-served feed mill then is not the availability of corn from other sources or other railroads, but the ability to obtain corn at the lowest delivered price, which, for a significant number of KCSR-served feed mills, is IC&E-originated corn.

The importance of IC&E-originated corn for these feed mills has been confirmed by the buyers themselves in statements filed with the Board:

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[4] KCSR does not have ready access to its 100% 2005 data without conducting a special study. KCSR switched data systems in the 2005 period as it was fully integrating the data systems of Tex Mex and KCSM, KCS's Mexican railroad subsidiary. As such, the 2005 data is not readily accessible. It is also possible that the 2005 Waybill Sample does not give an entirely accurate picture of KCS traffic because of the data integration issues during that period. KCSR provided Applicants' with KCSR's 100% traffic data for 2006 to avoid any distortions. Applicants have chosen not to use that 100% data.

> As noted in my November 30 statement, Tyson has multiple poultry feed mills in Arkansas, Oklahoma, and Mississippi. Those mills receive a substantial amount of their overall corn needs from The Kansas City Southern Railway Company ("KCSR"). All of that KCSR delivered corn comes from Iowa and Minnesota via IC&E origins pursuant to an agreement between IC&E and KCSR that allows KCSR to price and market the rail transportation component of the IC&E originated corn.

Mr. John Grass, Vice President – Input Exposure, Management Desk, Tyson Foods, Inc., one of the largest poultry companies in the world.

> Our clients tend to buy F.O.B. origin and thus end up paying for the transportation themselves; therefore it is very important that there not be any reduction in those transportation options. . . Many of our clients have multiple poultry feeds mills in Arkansas, Oklahoma, and Mississippi. Those mills receive a substantial amount of their overall corn needs from The Kansas City Southern Railway Company ("KCSR"). Most of that KCSR delivered corn comes from Iowa and Minnesota via IC&E origins pursuant to an agreement between IC&E and KCSR.

David W. Nutt, President, J.W. Nutt Co., which offers brokerage service and purchases corn for Pilgrim's Pride, Tyson, George's Farms, and OK Industries.

> We currently operate two feed mills located in Arkansas and Oklahoma served by The Kansas City Southern Railway Company ("KCSR"). We received in excess of 11,000 carloads of corn and soybean meal annually at our feed mills. Those mills received the majority of their overall corn needs from KCSR. A portion of that KCSR delivered corn comes from Iowa and Minnesota via IC&E origins pursuant to an agreement between IC&E and KCSR.

Mr. Russell E. Bragg, Division President, OK Industries, Inc. These statements belie the conclusions of Mr. Williams that IC&E-originated corn is not an important source of corn to the KCSR-served feed mills.

Having now established that Mr. Williams and others have presented an incomplete analysis of the importance of the IC&E originated corn to the KCSR served feed mills in the south-central U.S. poultry markets, I would like to address the argument that such feed mills could simply turn to other sources of corn to fill the void if the IC&E-originated corn was no longer available and that doing so would not result in economic harm to these feed mills. Rather than deal with theories and hypotheticals put forth by Applicants, it is best to again let the users of the IC&E-originated corn speak for themselves about what would happen if the IC&E-originated corn was no longer available due to that corn being diverted to other end users as a result of the market power gained by CP and the loss the DME neutrality.

> Any loss of those Iowa and Minnesota origins would require Tyson to receive corn from other KCSR origins, most likely Council Bluffs. This would result in Tyson having to pay more for its grain because the delivered price is significantly more than the grain available from the DM&E and IC&E origins.

John Grass, Tyson Foods.

> Any loss of those IC&E Iowa or Minnesota origins would require OK to receive corn from other locations. This would result in having to pay more for its grain.

Russell Bragg, O.K. Industries, Inc.

> J.W. Nutt Company supports the request by KCSR to ensure that the existing routing agreement with IC&E for Iowa and Minnesota originated corn remains available for the long term. Any loss of those IC&E Iowa or Minnesota origins would require our clients to receive corn from other locations and would result in their having to pay more for the rail component and the grain.

David W. Nutt, J.W. Nutt Co. Applicants' witnesses ignore these very real statements by the receivers that buying corn from other non-IC&E origins would result in increased prices. Instead, Applicants focus on incomplete and highly aggregated data in an attempt to prove their case that alternative sources of corn are available to KCSR served feed mills and at a lowered delivered cost basis.

Mr. Williams argues that my contention that KCSR-served receivers will incur additional costs to acquire corn was not supported by any quantitative data. He then attempts such a quantitative analysis. (Williams Reply V.S. at 20-22). He compares the average revenue per car from Iowa and Minnesota IC&E origins to destinations in Arkansas and Oklahoma (which, as he notes, are also served by UP and BNSF)[5] with the average revenue per car from Omaha/Council Bluffs and Atchison/Topeka (which are KCSR origins but are also origins for UP and BNSF)[6] to these same feed mill state destinations (but not to specific KCSR-served feed mills). Adding in corn prices, he then comes to the conclusion that the KCSR-served feed mills could have obtained corn from the alternate origins and would not have suffered economic harm from doing so.

The problem with his analysis is that it is not specific to the actual IC&E moves at issue. For the rate at IC&E origins, he is using an average rail rate, which average appears to be determined by averaging all rail rates for all corn originating in Iowa and terminating at all feed mills in Arkansas or Oklahoma, not the specific IC&E-KCSR rate from the Corn Lines to the KCSR-served feed mills in Arkansas and Oklahoma. For the Omaha/Council Bluffs and Atchison/Topeka origins, he is again using an average rail rate for all rail moves from that origin, which appears to include rates offered by UP and BNSF as well as KCSR at those origins, to all feed mills in the states of Arkansas and Oklahoma, which includes destination feed mills solely served by UP and BNSF as well as the KCSR-served feed mills. He is not comparing the specific IC&E-KCSR rate from Iowa and Minnesota to the KCSR specific rates out of Omaha/Council Bluffs and Atchison/Topeka to the KCSR-served destinations in the states of Arkansas and Oklahoma. As such, his analysis is incomplete.

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[5] He does not say that the average revenue per car from the IC&E origins to the destination states is average KCSR revenue. To the extent IC&E is also interchanging corn to UP and BNSF, who also serve the same destination states, then the average revenue per car would include those carriers.

[6] Here, because UP and BNSF also serve these origins and the destination states, the average revenue per-car appears to include UP and BNSF moves as well as KCSR moves. As such, this would not be an accurate picture of harm to KCSR receivers.

When one uses actual marketplace prices to actual KCSR destinations for actual customers, the "model" and "theory" posited by Mr. Williams falls apart. Using quantitative data based on the facts that exist today in the marketplace, one reaches a far different conclusion than Mr. Williams. In doing so, I am using Mr. Williams' 1Q Average corn price at each origin as reported by USDA reports (page 24 of his verified statement). Because my results are the same no matter what car size one uses, I used the standard covered hopper car and assumed 3,500 bushels of corn per railcar in this analysis. I also used a real shipper, Tyson Foods. For IC&E origins out of Iowa and Minnesota, Tyson uses the Grain Agreement for its prices. Tyson must use KCSR 4032 Tariff for determining prices from the KCSR origins at Council Bluffs and Kansas City. When comparing KCSR-only rates from the three origins to the same KCSR-only served destinations, a real world comparison, one reaches the following results.

JJR Spur, AR	Rail Rate	Price of Corn	Total Price	Difference
IC&E Origins	[redacted]	$4.81 x 3500 = $16,835 per car	[redacted]	
Kansas City	$1980.00	$5.04 x 3500 = $17,640 per car	$19,620	[redacted]
Council Bluffs	$2540.00	$4.92 x 3500 = $17,220 per car	$19,760	[redacted]

Hope, AR	Rail Rate	Price of Corn	Total Price	Difference
IC&E Origins	[redacted]	$4.81 x 3500 = $16,835 per car	[redacted]	
Kansas City	$1980.00	$5.04 x 3500 = $17,640 per car	$19,620	[redacted]
Council Bluffs	$2540.00	$4.92 x 3500 = $17,220 per car	$19,760	[redacted]

Waldron, AR	Rail Rate	Price of Corn	Total Price	Difference
IC&E Origins	[redacted]	$4.81 x 3500 = $16,835 per car	[redacted]	
Kansas City	$1910.00	$5.04 x 3500 = $17,640 per car	$19,550	[redacted]
Council Bluffs	$2460.00	$4.92 x 3500 = $17,220 per car	$19,680	[redacted]

Union, MS	Rail Rate	Price of Corn	Total Price	Difference
IC&E Origins	[redacted]	$4.81 x 3500 = $16,835 per car	[redacted]	
Kansas City	$2020.00	$5.04 x 3500 = $17,640 per car	$19,660	[redacted]
Council Bluffs	$2575.00	$4.92 x 3500 = $17,220 per car	$19,795	[redacted]

Craig, OK	Rail Rate	Price of Corn	Total Price	Difference
IC&E Origins	[redacted]	$4.81 x 3500 = $16,835 per car	[redacted]	
Kansas City	$1800.00	$5.04 x 3500 = $17,640 per car	$19,440	[redacted]
Council Bluffs	$2360.00	$4.92 x 3500 = $17,220 per car	$19,580	[redacted]

Hudson, OK	Rail Rate	Price of Corn	Total Price	Difference
IC&E Origins	[redacted]	$4.81 x 3500 = $16,835 per car	[redacted]	
Kansas City	$1615.00	$5.04 x 3500 = $17,640 per car	$19,255	[redacted]
Council Bluffs	$2170.00	$4.92 x 3500 = $17,220 per car	$19,390	[redacted]

Clearly, if Tyson were required to shift from IC&E origins to other KCSR-served grain origins, Tyson would have to pay more and suffer economic harm at their six feed mills served by KCSR. Tyson understands the very real implications of the Transaction. That is why they support the Transaction on the condition that KCSR's ratemaking authority for IC&E-served origins remains in place. Likewise, J.W. Nutt and O.K. Industries understand this as well. Indeed, these three buyers of IC&E-originated corn represent [redacted] of the total IC&E originated corn delivered to the south-central U.S. states of Arkansas, Mississippi, and Oklahoma by KCSR. All of them agree that an unconditioned transaction would result in economic harm.

Furthermore, the notion that corn that originates on UP, BNSF, CN, or NS, while certainly available to KCSR-served feed mills in Arkansas and Oklahoma via an interchange with KCSR, is going to be interchanged to KCSR and delivered to the KCSR-served feed mills at a total delivered price that is less than the IC&E-KCSR rail rate is just not reality. Likewise, I disagree with Mr. Anderson's views (Reply V.S. Anderson at 12) that locally grown corn can replace IC&E corn as an alternative source. While locally grown corn is used by some of our feed mills today, at most of our feed mills, such locally grown corn has not traditionally been, nor is it likely to be, a readily available source at comparable prices to the IC&E corn. The bottom line is that IC&E-KCSR delivered corn represents the lowest delivered price for a number of KCSR served feed mills and the three largest buyers of that corn have all filed comments of concern and support for KCSR's requested condition.

Absent a condition preserving KCSR's ratemaking authority, it is clear that the delivered price of corn will rise as a result of the Transaction if the KCSR-served feed mills have to turn to other sources of corn. This Transaction-related price increase will come on top of price increases that these feed mills are already incurring due to other market forces. It is true that the poultry industry in the U.S. is already paying more for corn than they did previously, whether they are KCSR-served, UP-served, BNSF-served, or served by one of the many short-line railroads. With the expansion in the ethanol markets and the added demand in the export markets, the price of corn has risen dramatically and will continue to do so. Yet despite these market-based increases, today, based on the existing economics, IC&E-originated corn is still the lowest cost option for many of our feed mills. By eliminating this option through diversion to other markets or through downgrading turn times and service levels, CP will eliminate the lowest price option for many of our feed mills.

This proceeding shows CP's thinking on the Grain Agreement. They want IC&E corn to "diversify" and they want the Grain Agreement to go away. They have clearly stated both objectives on the record. If they didn't want to eliminate DME's neutrality, then they would have reached an agreement with us on this issue and this discussion would not be happening. But it is clear, if KCSR does not have the ability to protect our feed mills' corn originations, these feed mills will be paying more on a comparative basis after this Transaction than before it.

B. Corn Line Grain Elevators And The USDA Have Competitive Concerns That Remain Unresolved

Not only do the feed mills understand the importance of ensuring KCSR's ratemaking authority to IC&E corn origins, but the United States government does as well. In its initial March 4 comments, the United States Department of Agriculture ("USDA") understood the need to maintain DME's neutrality and KCSR's ability to connect with a merged CP-DME system on a neutral basis. It stated that:

> USDA requests that the Board condition this acquisition with the requirement to maintain cost-competitive and non-discriminatory connections to other railroads. The basis for this request is the importance of preserving rail-to-rail competition.

Upon reviewing the March 4 comments, USDA filed reply comments on April 18 which further explained USDA's concerns and comments. It stated:

> Another example of the principle expressed in our March 4 comments is the existing agreements between Kansas City Southern Railways (KCS) and the DM&E system. USDA requests that the Board condition its approval of the CP purchase of DM&E with the requirement that cost-competitive and non-discriminatory connections be maintained with KCS as well. USDA contends that it is in the public interest to preserve the neutrality of the DM&E system which would preserve the ability of shippers to choose the markets in which they sell their products and the rail carrier

USDA's concerns about the need to maintain DME's neutrality and KCSR's ability to access IC&E origins on a neutral basis also formed the basis for many of the comments received by the actual elevators, or their representatives, who are located on the IC&E lines and ship to KCSR destinations. For example, MFA Incorporated, which is a Regional Agricultural

Cooperative with 45,000 farmer owners, markets 60 million bushels of grain annually, and which ships via the IC&E to KCSR destinations, stated:

> If CP acquires IC&E, IC&E will lose its neutrality. CP will naturally favor grain buyers located on its lines and it will adjust the rail rates so as to foreclose our ability to market to destinations on other Class I carriers. This will result in fewer markets for our grain, not more, and will ultimately reduce the prices we can obtain in the marketplace... We are concerned that CP will not honor the KCSR/IC&E agreement for the long term, and will, at the end of that agreement, foreclose KCSR routing options in favor of CP destinations. Yet, we need the long term assurance that the KCSR routing option will remain available in a post-transaction environment. A loss of that routing option would have significant negative impacts on our company.

Similar concerns were expressed by the Southern Minnesota and Northern Iowa Shippers Association ("SMNISA"), whose members operate "virtually all of the 46 grain elevators located on IC&E," and Ag Processing, a regional cooperative owned by 190 local and regional cooperatives with facilities located on IC&E lines. While both of these associations support the Transaction, they do so only on the condition that CP, in a post-Transaction environment, maintains the "ability [redacted] (if they choose) to ship corn to poultry feeders and other end users via the Kansas City and Chicago gateways." SMNISA at 3.

II. THE OPEN GATEWAY COMMITMENT DOES NOT RESOLVE THE COMPETITIVE CONCERNS OF THE SHIPPERS, RECEIVERS, OR USDA

To resolve the concerns of the origin shippers, and presumably those of the feed mill receivers and the USDA, Applicants have pledged to "keep open all gateways affected by the proposed transaction on commercially reasonable terms" and are willing to accept such a condition as part of the STB's approval of the Transaction. This pledge obviously recognizes, notwithstanding Applicants' numerous statements that the Transaction would not result in a reduction of competition, that there are in fact competitive consequences caused by the Transaction for which a condition is necessary to remedy. Yet, this pledge alone does not resolve the competitive concerns raised by KCSR, the receivers who pay the freight, or USDA. Indeed, I note that not one feed mill receiver who has filed comments has changed its position because of this pledge, nor has USDA. This is likely due to the fact that the pledge and proposed condition has several shortcomings.

The pledge is extremely vague. The phrase "affected gateways" is not defined and is not consistent with the Ag Processing's or SMNISA's views of the CP pledge, both of which believe the pledge specifically means Kansas City and Chicago. Does the pledge mean Kansas City and Chicago? If so, CP should say so, and at a minimum, the Board should make clear that Kansas City and Chicago are "affected gateways" governed by the pledge. The phrase "commercially reasonable terms" is also not defined. Likewise, the commitment says nothing about car supply, transit times, and service standards, which are of crucial importance to the shippers and receivers of IC&E-originated grain. Nor has CP made the standard other pledges to (1) not modify or cancel contracts;[7] (2) maintain the rights of shippers to challenge bottleneck rates under the so-called "contract exception;" and (3) submit to post-transaction monitoring and reporting. The Board, at a minimum, should impose these conditions as well as a more stringent open gateway condition.

As I have previously noted, even if CP cannot cancel the Grain Agreement, because it contains no volume commitments or meaningful service standards, CP can simply use its control of the IC&E origins to downgrade service during the pendency of the Grain Agreement to disincentivize for movements to KCSR destinations, even with the existence of the open gateway

[7] CP claims the Grain Agreement cannot be cancelled for [ten] more years. By its terms, this is true. But while I am not a lawyer, I understand that carriers can cancel contracts as part of a Board-approved transaction if doing so is necessary to achieve a benefit of the proposed transaction. The Board needs to make it clear that CP cannot cancel any of its or DME's contracts with KCSR except as set forth in those contracts.

pledge. Of course, after expiration of the Grain Agreement, the open gateway commitment, even assuming it applies to Kansas City and Chicago, does nothing to prevent CP from charging different rates for interchanges with its alliance partner UP at these same gateways vis-à-vis KCSR, from changing the car supply[8] and service terms, or from manipulating its rates so as to discourage shipments to the "open gateways" of Kansas City and Chicago so as to divert this grain to different destinations, particularly the PNW.

As I've noted, even during the terms of the Grain Agreement, CP can downgrade the transit times by reducing car supply turn times. It is true that if CP does this by more than [redacted], CP will incur a penalty of [redacted] per car per day of delay, but this is a small penalty. Indeed, today, IC&E receives between [redacted] and [redacted] per car from Sheldon, IA (on the Corn Lines) to Kansas City. A [redacted] penalty represents less than [redacted] of revenue. This is not much of a penalty, especially when CP can gain substantial revenues by diverting IC&E corn to other destinations.

The issue of whether Applicants will maintain an adequate car supply for IC&E-originated grain in a post-Transaction environment is real and remains unresolved by Applicants' open gateway commitment. When CP previously owned the IC&E lines, CP gained a reputation for failing to maintain the line or provide adequate car supply. In fact, due to this history, USDA specifically noted at page 3 of its March 4 comments that:

> Some IC&E shippers also are concerned about adequate grain car supply. These shippers have stated that CP did not provide an adequate supply of grain cars when it operated the current IC&E lines. Thus, USDA requests that the Board encourage CP to maintain the number of grain cars available to agricultural

[8] I note that Mr. Anderson has already indicated that it may, upon expiration of the Grain Agreement, seek to deploy its "own fleet in handling traffic that moves in KCSR equipment today." (Reply V.S. Anderson at 16). This would have an adverse financial impact on the KCSR grain car fleet which KCSR has dedicated to service under the Grain Agreement.

> shippers on the DM&E system at the levels provided during 2007 and that CP not favor Canadian shippers over those from the U.S.

USDA reiterated this concern in their April 18 Reply Comments when it stated:

> USDA also requests that the Board consider conditioning this application with the requirement that CP maintain the number of grain cars available to agricultural shippers on the DM&E system at the levels provided during 2007 without reducing the supply available to North Dakota shippers. In addition, USDA reaffirms its request that CP not favor Canadian shippers over those from the U.S.

The "open gateway" commitment does nothing to resolve USDA's concerns. In fact, although perhaps not intended to implicitly confirm the legitimacy of USDA's concerns, certain statements by Applicants' own witnesses seem to do just that. These statements confirm that CP will have both the opportunity and the incentive to reduce service and car supply when the Grain Agreement expires. In the Reply Verified Statement of Don Smith ("Reply V.S. Smith"), in attempting to refute KCSR's assertions that CP will seek to divert IC&E originated corn to other destinations, particularly the PNW, Mr. Smith states (on page 6) that "[t]he added cost of gathering cars from multiple country elevators to build unit trains presents a further obstacle to the competitiveness of CP-UP interline service from the Corn Lines origins to the PNW." Mr. Anderson, in his Reply Verified Statement ("Reply V.S. Anderson") at page 6 also brings up the added cost of building unit trains as the reason such Corn Lines traffic will not be diverted away from KCSR destinations. To further show their thinking on this subject, Mr. Smith (Reply V.S. at 6-7) says that "[g]iven the uncertainty regarding the future volume of long-haul shipments of corn from IC&E-served origins, it would be imprudent for CP to make long-term investments in cars and locomotives to handle such traffic."

Under the Grain Agreement, which took effect over ten years ago, KCSR is to provide the cars. As such, KCSR invested substantially into its grain car fleet so as to provide cars for the IC&E-originated corn. Today, KCSR uses approximately 225 cars in its KCSR-IC&E

service routings under the Grain Agreement. We have historically run on average three seventy-five car units on a continual basis for this business. Also, unlike CP, IC&E is willing to work with KCSR to build unit trains out of smaller unit size origination. Under the agreement, KCSR gives IC&E 75-car unit trains. IC&E takes that unit train, breaks it up into no more than 3 different unit sizes, and then delivers those units to up to three different origins for loading. Once the cars are spotted at the last origin, the clock starts, and IC&E's shippers have [redacted] hours to load the train. The IC&E crew then picks up the cars, reassembles them back into 75 car unit trains, and delivers them back to KCSR for movement to the KCSR feed mills.

As noted above, in an attempt to argue why CP will not divert Corn Lines corn to the PNW, witnesses Anderson and Smith testify that because IC&E grain elevators cannot take 75 or 100 car unit trains at origin, it would be too costly and time consuming for CP to build unit trains for corn movements from IC&E elevators to the PNW or other long haul destinations that utilize unit train service. They are in effect saying that the IC&E-KCSR operating practice is not a good thing, too costly, and is not something that CP would undertake. Yet, taking the time and expense of building such unit trains out of less than unit train blocks is the precise reason why the IC&E-KCSR Grain Agreement has been so successful and so well received by both the grain elevators and the receivers.

If such an operating practice makes it too costly to go to the PNW, then it will be just as costly, in CP's mind, to do the same thing with the KCSR move to the south-central poultry markets. As a result, CP will obviously seek ways to eliminate the existing operating practice so as to make the Grain Agreement a nullity, and CP will certainly not want to undertake such practices when the Grain Agreement expires – open gateway commitment or not. In addition, Mr. Smith says that "it would be imprudent for CP to make long-term investments in cars and locomotives to handle such traffic, "i.e. long haul movements of IC&E originated corn off of the Corn Lines" Yet, CP wants this Board, and the shippers who have relied upon CP's open gateway representation, to believe that CP will take no action to undermine the Grain Agreement and will keep the Kansas City gateway open to CP(IC&E)-KCSR routings to the south-central poultry markets when that agreement expires. CP's arguments are not convincing when considered in light of their witnesses' own testimony. Such testimony is telling, and the story it tells is that the commercially reasonable terms that exist today will be changing in the future. Yes, the Kansas City gateway will, in theory, be open, but CP will want more money to build trains for such movements or will eliminate that option all together.

While, in a post Grain Agreement world, the open gateway commitment would require CP to quote a commercially reasonable rate for KCSR interline service between the Corn Line origins and the interchange with KCSR at the Kansas City gateway (again, assuming that Kansas City is an "affected gateway," which it obviously is) or a commercially reasonable interline rate between Chicago and Kansas City over the (then former) IC&E route for interchange with KCSR at Chicago, such guarantee does not guarantee service, car supply, or that the rate quoted KCSR would not be discriminatory vis-à-vis CP-UP interchanges at Chicago or Kansas City. CP would be free to quote a high rate to KCSR and a substantially lower rate to UP. Indeed, I note that nowhere in the legal comments or witness statements in CPR-14/DME-14 does CP commit that it will continue to interchange with KCSR at Kansas City or that it would not favor UP interchange vis-à-vis KCSR.

The open gateway commitment falls far short of the USDA's request that the "Board condition its approval of the CP purchase of DM&E with the requirement that cost-competitive and non-discriminatory connections be maintained with KCS as well." USDA April 18

Comments at 3. The open gateway commitment does not, in a post-Grain Agreement world, require CP to provide cars, does not require them to treat KCSR in a non-discriminatory manner at the Kansas City gateway vis-à-vis UP, and does nothing to guarantee service standards and transit times. On the other hand, making sure that KCSR's Grain Agreement is extended or made permanent would provide a readily available source of car supply, maintain the existing operating practices of allowing elevators who do not have 75 or 100 car loading capacity to nonetheless ship in unit train service, and give the Corn Lines grain elevators the choice to ship their grain via the KCSR to the poultry markets in the south-central U.S. or to CP-served destinations to the PNW, Great Lakes, Chicago, or Canadian domestic use.

The simple truth is that the CP "open gateway" commitment is too vague and undefined to resolve the competitive concerns that CP itself now admits exist and have been expressed by the grain elevators, the grain receivers, and the USDA. Without further action by this Board, the commitment does not resolve concerns over service, over car supply, nor does it maintain the neutrality of the existing DME system, which currently allows the shipper to choose where to ship, not the railroad. The appropriate fix to the competitive concerns is to make the KCSR Grain Agreement permanent or at least preserve KCSR's ratemaking authority to the Corn Line origins.

III. MAINTAINING THE KCSR COMPETITIVE PRESENCE TO THE CORN LINES IS THE ONLY WAY TO ENSURE THAT THE BENEFITS PROMISED TO DME SHIPPERS WILL BE MAINTAINED

Applicants' have consistently argued that the Transaction is pro-competitive in nature for DME shippers because it will result in single-line service to many new markets that DME shippers cannot currently access except via, presumably, inefficient and costly joint-line service. This has been particularly the case with respect to DME grain shippers, including shippers on the

Corn Lines. According to Mr. Williams, "DME-served grain shippers will gain direct access to domestic end users in the U.S. Northeast and to Great Lakes export terminals at Duluth/Superior through single line service via the expanded CP system. These new rail transportation opportunities will be of value to corn shippers on both DME and ICE, since none of their corn moved to those markets in 2005, as shown by my Attachments JHW-2 and JHW-3." Other statements discuss the benefits of new single-line routings to the PNW or to domestic Canadian markets. For example:

> Verified statement of David Owen on behalf of the South Dakota Chamber of Commerce states: "Our business will now be able to ship direct to markets east of Chicago, as well as to markets in the Pacific Northwest."

> Verified statement of Mayor Clayton Pyle on behalf of the City of Hartley, Iowa states:"The broader network that the transaction will create will give Hartley area shippers single-line service to more destinations on Canadian Pacific's network."

> Verified statement of Vikki Day on behalf of the City of Highmore, South Dakota states: "After the acquisition, Highmore's shippers will have single-line access to markets east of Chicago, Illinois, as well as access to the Pacific Northwest."

> Verified Statement of Duane Sanger on behalf of the City of Redfield, South Dakota states: 'The proposed acquisition will allow our shippers to reach both export and import markets on Canadian Pacific's single-line service, which includes markets in the Pacific Northwest and the Eastern United States."

I have stated all along that to the extent the Transaction does result in giving grain shippers single-line access to new markets, without foreclosing access to existing markets, then that is a good thing from the origin shipper standpoint. Indeed, such potential benefit explains why most of the origin shippers are supporting the Transaction. Any increase in demand for grain is a good thing for these elevators. From an origin elevator's standpoint, the more options they have to sell corn, the better it is for them. CP has told them that they intend to diversify their corn shipments once the acquisition is complete and intends to provide them "single line" service to numerous destinations. These destinations include Duluth/Superior, the eastern United

States, and Canada. It also includes the PNW, or at least as noted above, the shippers responding with letters of support seem to think the PNW is included and have been apparently told that will happen. Yet, Applicants' witnesses make it clear that access to the PNW will not be via single-line CP access, but rather through CP-BNSF movements via the existing DME-BNSF agreement or CP-UP movements via their alliance and routing agreements. According to Applicants, the CP single-line service to the PNW is too circuitous and inefficient. Thus, those Shippers who are depending upon single-line service to the PNW are going to be sadly disappointed.

The Corn Line Shippers also believe that the Transaction will result in single-line access to the PNW without foreclosing access to the existing poultry markets. The Southern Minnesota and Northern Iowa Shippers Association, which represents "virtually all of the 46 grain elevators located on IC&E," including the elevators on the Corn Lines, says (emphasis added):

> [T]he transaction will give our members single-system access to a variety of additional destinations for their grain shipments, including the ports of Duluth/Superior, the U.S. Northeast and points throughout both eastern and western Canada. Such access will provide our members opportunities to tap new markets, and enable them to compete more effectively with elevators served via CN single line service. *CP Service to the Pacific Northwest will offer an additional competitive option for corn shipments moving to export markets.*

KCSR's argument has been, and continues to be, that indeed, it is part of CP's strategic and economic plans to encourage movement of corn from the Corn Lines to the PNW, whether or not this is done in conjunction with a CP-BNSF routing, a CP-UP routing, or eventually via CP's single-line route to Vancouver. In fact, as noted by Mr. Smith (Reply V.S. Smith at 9), CP has invested heavily into improving its routings to the PNW by adding infrastructure, capacity, and increasing the efficiency of such PNW routings. CP has publicly and consistently said that it wants to encourage routings to the PNW. CP has gathered shipper support letters on the basis that the Transaction will result in single-line access to the PNW markets for the DME shippers, including the Corn Line Shippers. The association representing the grain elevators on the Corn Lines supports the transaction, in part, on that basis. Yet, in their reply comments, Applicants and their witnesses spend page after page arguing why the corn off of the Corn Lines will not in fact be moved to the PNW, which, if true, undermines the basis for the support given by the very shippers who CP relies upon as evidence of the benefits of the Transaction. Either CP has not told the whole story to the Corn Lines shippers or they are not telling the full story to the Board. The Board should not allow Applicants to put forth conflicting and misleading stories.[9]

KCSR witness George Woodward, both in his original verified statement and his rebuttal verified statement, which I have reviewed (the redacted version), makes it clear that CP does in fact have an economic incentive to divert corn from the Corn Lines to the PNW, but such a diversion will not be in addition to, but in lieu of, the shippers' current option to route to the poultry markets in the south-central U.S. My own experience and analysis confirms Mr. Woodward's conclusion. Today, UP has published rates from Sheldon, IA (on the Corn Lines) to the PNW at a rate of $4610 for cars less than 5,001' cubic capacity and a rate of $5,048 on cars greater than 5,001' cubic capacity. Using mileages supplied by Mr. Anderson, Mr. Smith, and Mr. Williams in their verified statements, it would take IC&E-CP-UP 2,192 miles to get to

[9] Another example of what appears to be outright duplicity involves traffic from New Ulm, MN. The City of New Ulm adopted a resolution, which was included in Applicants' reply comments, that supports the Transaction because the Transaction would provide "desirable *single-line service* to the East and West Coasts." Yet Mr. Anderson (Reply V.S. Anderson at 3-7) states that diverting shipments from New Ulm or other origins to CP-UP routings or CP single-line routings to the PNW would not happen due to the circuitous nature of such routes. Clearly New Ulm shippers will not benefit from new single-line service to the West Coast, although they have apparently been told that they would. Mr. Russ Lucas on behalf of the City of Claremont, Minnesota, also states: "Without having to resort to other modes of transportation, our shippers will be able to reach markets east of Chicago as well as markets in the *Pacific Northwest on the Canadian Pacific's reliable and efficient single-line service*." As with New Ulm, and according to Mr. Anderson's analysis and that of Mr. Smith, the City of Claremont is also not going to benefit from CP single-line service to the PNW.

the PNW export ports from Algona, IA and 2,155 from Winnebago, MN, two points on the corn lines. Sheldon, IA would add 84.6 miles to the Algona, IA mileage for a total of 2,276.6 miles to the PNW (from PC Miler Version 14.0). Based on the assumption that IC&E-CP-UP would divide the revenue on a mileage prorate basis, which I realize is not always the way divisions are divided, however in many instances it is the fair way to divide revenue, a mileage prorate would give each party $2.02 per mile on small cube cars and $2.22 per mile on larger cube cars. For IC&E-KCSR feed mill business today, IC&E receives between [redacted] and [redacted] per car from Sheldon, IA to Kansas City, a distance of 714.3 miles. That equates to [redacted] per mile. In a post-transaction environment, would CP rather collect [redacted] per mile and [redacted] per car or somewhere between $2.02 and $2.22 per mile and $3595.61 to $3841.71 per car?[10]

When looking at the CP-UP routing to the PNW, Mr. Anderson, and Mr. Smith comment on the "highly efficient Florence interchange" with the BNSF and go on to state, "It is highly unlikely that such a circuitous routing (i.e. a CP-UP routing to the PNW) could be competitive, on either a cost or service basis, with BNSF's direct route to the PNW." Yet, this statement does not comport with the fact that today, there are moves of corn to the PNW that are similar in distances. For example, in conjunction with DM&E, the BNSF has rates published out of New Ulm, MN at $3420.00 per car over the Florence interchange. This rate applies on standard covered hopper cars (not jumbo covered hoppers). Using Mr. Anderson's mileage calculation of 2,140 miles from New Ulm, MN to Seattle (or Kalama) via a CP-UP routing over Kingsgate, and

[10] I do not agree with Mr. Anderson's assertion (Reply V.S. Anderson at 7) that because corn off of the Corn Lines is not moving to the PNW now, it won't move that way in the future. Because DME currently acts like a gigantic neutral switching carrier, it has no incentive to favor one connecting carrier or rail route over another. As a result, the corn moves where the corn buyer market dictates. CP control will eliminate DME's neutrality. CP will manipulate the rail rates so as to raise the delivered price for buyers located on non-CP routes and thereby eliminate the shippers' ability to market to those locations; forcing the corn to move only on CP favored routes, which in this case, will be the PNW.

using a mileage prorate to divide the divisions, the more circuitous route would offer CP $1.60 per mile.[11] As with the Sheldon, IA examples above, would CP want to receive [redacted] per mile and [redacted] via the KCSR routing or $1.60 per mile and $2,550.24 via the CP-UP routing?

Obviously, despite Applicants' protestations to the contrary, CP will have every economic incentive to divert corn from the Corn Lines to the PNW. This is confirmed by George Woodward, my own analysis, CP's capital expenditure and strategic plans, and the shippers themselves, who fully expect such a routing to be available to them.[12] Of course if CP did in fact open up PNW routings in addition to the IC&E-KCSR routings to the south-central U.S., this would be beneficial to the IC&E grain elevators. If the diversions do not occur because CP will not supply the cars, the agreement with UP does not allow for additional capacity, or the route is too circuitous, which are the reasons put forth by Applicants' witnesses, then the basis for much of support for the Transaction expressed by the Corn Line shippers, U.S. DOT, USDA, and others is illusory.

Permanent KCSR ratemaking authority to the Corn Lines with enforceable service standards is the only way to ensure that Corn Line shippers maintain their access to all of the potential routing options. Absent a service standard, CP will, during the course of the Grain Agreement, reduce service so as to favor CP routings. After expiration of that agreement, CP will be free to price its routing to the Kansas City gateway in a discriminatory fashion so as to

[11] The per mile revenue increases to $1.78 per mile if when one uses jumbo covered hoppers over the same route.

[12] I find it interesting that Mr. Smith claims that diversions to the PNW would not occur because CP does not have adequate car supply to handle that business (Reply V.S. Smith at 6), but then, Mr. Anderson says that upon expiration of the Grain Agreement, DME would likely deploy its own car supply fleet to handle the corn moves off of the Corn Lines. (Reply V.S. Anderson at 16). Such an action by DME would mean that CP would have the cars necessary to provide service from the Corn Lines to the PNW.

favor the PNW or other CP routings. Maintaining a permanent KCSR presence allows KCSR to fairly, and in a neutral way, compete for the Corn Lines business against other CP routings, including to the PNW. Maintaining the KCSR presence thus allows the market and the shippers and receivers to choose either a PNW routing or a south-central U.S. routing. Eliminating the KCSR presence allows CP to dictate the routings and eliminate a competitive alternative that currently exists.

IV. THE KCSR-IC&E ROUTING FROM CHICAGO TO KANSAS CITY PROVIDES COMPETITIVE ROUTING OPTION THAT CP WILL SEEK TO ELIMINATE

As previously set forth in KCSR's March 4 comments, KCSR currently has another agreement with IC&E that provides KCSR with ratemaking authority over IC&E's line between Kansas City and Chicago – the so-called "Chicago Haulage Agreement." While it is true that KCSR has not actually moved traffic under the precise pricing and service terms as set forth in the agreement, the existence of the agreement nonetheless provides an important competitive routing option in the Laredo-Kansas City-Chicago corridor. It provides the framework by which a neutral DME and KCSR negotiate joint-line rates and interline service in that same corridor. The Transaction will result in CP eliminating the existing cooperative relationship between DME and KCSR.

CP attempts to downplay the importance of the Chicago Haulage Agreement and minimize its impact, but in doing so, Applicants have made several statements that do not accurately portray the competitive impact of that agreement. If one understands both the context and the use of the Chicago Haulage Agreement, it is clear that KCSR and DME have been able to develop an effective routing option in the Laredo-Kansas City-Chicago corridor which CP would not likely continue given its relationship with UP and its existing use of a CP-UP interchange through the Minneapolis/St. Paul gateway for NAFTA traffic.

First, Mr. Anderson claims that "IC&E and KCS have had a clear understanding that the IC&E-KCS Chicago Agreement is a 'dead letter.'" (Anderson Reply V.S. at 13). Unfortunately, he states later (Anderson Reply V.S. at 14), while discussing the need for open gateways, "This commitment ensures that shippers will continue to have the ability to route traffic via DM&E-IC&E-KCS routings following the proposed transaction, regardless of whether the IC&E-KCS Grain Agreement and/or the IC&E-KCS Chicago Haulage Agreement continue beyond their current terms." Perhaps IC&E knows, as does KCSR, that the Chicago Haulage Agreement provides a basic framework, from both a price and service standpoint by which DME and KCSR negotiate joint-line service between the Kansas City gateway and Chicago. Mr. Anderson is correct that all traffic moving in IC&E-KCSR interline service is done under "customary joint rate and divisions arrangements, rather than under the haulage agreement," but he neglects to inform the Board that such joint rate and divisions arrangement are usually negotiated using the Chicago Haulage Agreement as the basic building block and then adjusting the terms of that agreement to come up with "customary joint rate and divisions arrangement." While the Chicago Haulage Agreement could be construed as a "dead letter," as Mr. Anderson admits, the Agreement has never been cancelled and does still exist as its current term has not expired and is valid until its 90-day cancellation clause is invoked by either party.

Second, contrary to Applicants' assertions (particularly those of Mr. Williams), the IC&E route between Kansas City and Chicago is in fact very important with respect to KCSR traffic in the Chicago-Kansas City-Laredo corridor. The KCSR-IC&E route to/from Chicago via the Kansas City gateway is of vital importance to our shippers. As Exhibit 2 to this statement shows, in 2007, IC&E moved [redacted] southbound cars over its route from Chicago to the interchange with KCSR at Kansas City. Conversely, IC&E received from KCSR [redacted] northbound cars at the Kansas City gateway for movement to Chicago. No other joint-line service between KCSR and any other carrier moved more cars between Kansas City and Chicago than the existing IC&E-KCSR relationship.

Applicants further downgrade the importance of the KCSR-IC&E routing option by pointing out that "customers routed southbound NAFTA traffic via 27 different southbound rail routes and 30 northbound routes that were independent of Applicants." (CPR-14, DME-14 at 36). This analysis did not focus on the Chicago-Laredo corridor but included many other origins and all Mexican border destinations. It also ignored whether those routings are truly independent routings, i.e., actually competed against each other. Indeed, there are only two railroads serving Laredo: UP and KCSR. Thus, any traffic going to/from Chicago and Laredo must be interlined with either UP or us. Applicants' analysis misses the point that the IC&E-KCSR routing between Chicago and Laredo provides an independent competitive alternative to UP's dominance of that corridor. CP would have the Board ignore the diminution or elimination of this independent routing.

The Board doesn't have to take my word as evidence of the importance of the KCSR-IC&E relationship to provide an effective competitive alternative to UP's dominance of the Laredo to Chicago NAFTA market. The best evidence comes from the shippers themselves. As Boise Cascade in their March 19 letter so aptly put it:

> KCSR and IC&E are partners in providing rail transportation between points south of Kansas City to/from Chicago, particularly for NAFTA traffic to/from Laredo and Chicago. Boise Cascade makes use of such KCSR/ICE service. KCSR provides the rail service south of Kansas City, while IC&E participates in the service from Kansas City to Chicago. Boise Cascade regards KCSR-Kansas City-IC&E service to Chicago as an important competitive alternative to Union Pacific Railroad Company's ("UP") service in the same markets. As KCSR has pointed out, if Canadian Pacific Railway Company ("CP") is permitted to acquire unconditioned control of IC&E, CP may no longer have an incentive to work with KCSR for Chicago traffic because such service would compete with the same

service currently provided by UP and CP, especially for NAFTA traffic via the Chicago gateway. Clearly, such a turn of events would reduce our service options, and undercuts competition in the overall NAFTA corridor.

Finally, CP claims that its open gateway commitment ensures that this routing will remain available to shippers and that CP would be willing to work with KCSR to move traffic in the Chicago-Kansas City-Laredo market. Yet, the facts belie such an assertion For whatever reason, whether it is due to its alliance with UP, or its desire to use other gateways for Laredo traffic, such as Minneapolis/St. Paul, whereby CP and UP interchange almost all of CP's NAFTA traffic,[13] CP does not have the same incentive as DME to maintain and foster a KCSR-CP routing in the Laredo-Kansas City-Chicago corridor. Indeed, CP's actions already confirm CP's intent to dilute the importance of this independent IC&E-KCSR routing.

As I have previously noted, and is also discussed by Mr. Anderson, upon learning of the proposed transaction, I was asked to approach DME to determine if DME would be willing, upon consummation of the Transaction, to modify the terms of the existing Grain Agreement and the Chicago Haulage Agreement. Indeed, even prior to the announcement of the Transaction, [redacted][14] Those discussions were moving forward on a positive note when Mr.

[13] Such a CP-UP routing, by the way, would be included in Applicants' superficial analysis of the other 30-some NAFTA routings supposedly available to shippers if the KCSR-IC&E routing were eliminated. How replacing an independent KCSR-IC&E routing with a routing that includes UP somehow shows that there is plenty of competitive alternatives to UP's dominance of the Chicago-Laredo market is not explained. Likewise, the CP-UP routing today competes against the IC&E-KCSR routing. CP has not explained why it would have an incentive to use the IC&E route to Kansas City to interchange with KCSR at Kansas City (rather than UP) in light of the fact that it already uses the Minneapolis/St. Paul gateway and it already interchanges its NAFTA traffic with UP.

[14] Counsel has informed me that e-mails related to my discussions with DME were included in KCSR-2. [redacted]

Guthrie sent his letter January 29, 2007 letter to Mr. David Reeves informing KCSR that CP had no desire to discuss modifying the Chicago Haulage Agreement. This shows that CP does and has different incentives and strategic plans than DME with respect to the IC&E-KCSR agreement and will seek to change DME's existing policy of working with KCSR on NAFTA traffic.

Of course CP attempts to refute this notion in its Reply. CP claims that it is interested in working with KCSR to develop NAFTA traffic. Mr. Smith states that, "KCS grain marketing personnel have recently engaged in discussions with their counterparts at CP (including me) regarding the potential for developing shipments of grain via a CP-IC&E-KCS routing to Mexico." (Reply V.S. Smith at 7). This is partially true, but as with numerous CP statements, does not tell the whole story. On March 19, 2008, Mr. Smith called Matt Franko, KCSR Assistant Vice President Ag & Minerals, and asked him about the potential for developing shipments of grain via a CP-IC&E-KCS routing to Mexico. At that time, Mr. Franko, who works for me, sent an e-mail requesting further information from Mr. Smith. Mr. Smith sent some limited information on March 21. Since that time, Mr. Smith has not followed up or pursued the matter further. It appears that Mr. Smith may have made his inquiry solely for the purpose of putting it in his statement so as to make a "show" to the Board that CP was "engaged in discussions" regarding moving NAFTA traffic over a CP-IC&E-KCSR routing. Such discussions are a charade.

CP works with UP for the movement of NAFTA traffic via the Minneapolis/St. Paul interchange, not KCSR. In a post-transaction world, it will likely continue to do so. Alternatively, if CP does use the Kansas City gateway as a result of its open gateway

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[redacted]

commitment, given its relationship with UP and the dominance of UP to the Laredo market, CP will have incentive to interchange its traffic with UP. Absent some form of permanent ratemaking authority for KCSR traffic moving between Kansas City and Chicago, or perhaps a condition requiring KCSR and CP to negotiate a mutually acceptable haulage agreement, the Transaction will result in the elimination of one of the few independent routings available to shippers in the Laredo-Kansas City-Chicago corridor.

VERIFICATION

I, Michael R. Bilovesky, declare under penalty of perjury that the foregoing statement is true and correct. Further, I certify that I am qualified to file this Rebuttal Verified Statement. Executed this 19th day of May, 2008.

Michael R. Bilovesky

KCS Grain and Grain Products Destinations

Operating Company	Location	State	Car Capacity	Serving Carrier	Interchange	Commodities	2005, 2006, 2007 Recv'd IC&E Corn
ADM	Kansas City	MO	75	KCS	Direct	Sbns, YC, SRW	
Cargill Oilseeds	Kansas City	MO	7	KCS	Direct	Sbns	
Hansen-Mueller	Kansas City	MO	25	KCS	Direct	Sbns, YC, Sorghum, HRW, SRW	
American Ingredients	Grandview	MO	5	KCS	Direct	Stearic Acid, Glycerine	
Missouri Ethanol	Laddonia	MO	25	KCS	Direct	YC	
ConAgra *	Sherwin	KS	75	SKO	Pittsburg, KS	YC, Soy Meal	Y
Peterson Farms *	Peterson	AR	25	KCS	Direct	YC, Soy Meal	Y
McKee Foods	Gentry	AR	7	KCS	Direct	Sugar, Bakery Products	
Cobb-Vantress *	Siloam Springs	AR	12	KCS	Direct	YC, Soy Meal	Y
Tyson Foods *	Hudson	OK	48	KCS	Direct	YC, Soy Meal	Y
OK Foods *	Heavener	OK	50	KCS	Direct	YC, Soy Meal	Y
OK Foods *	Ft Smith	AR	35	KCS	Direct	YC, Soy Meal	Y
Tyson Foods *	Waldron	AR	25	KCS	Direct	YC, Soy Meal	Y
Pilgrim's Pride *	Anthony	AR	32	KCS	Direct	YC, Soy Meal	Y
Tyson Foods *	Hope	AR	23	KCS	Direct	YC, Soy Meal	Y
Tyson Foods *	JJR Spur	AR	25	KCS	Direct	YC, Soy Meal	Y
Pilgrim's Pride *	Nashville	AR	23	KCS	Direct	YC, Soy Meal	Y
Tyson Foods *	Craig	OK	100	DQ&E	DeQueen, AR	YC, Soy Meal	Y
H J Baker	Westville	OK	5	KCS	Direct	Animal Feed Ingred, Poultry Meal	
Peco Foods *	Gordo	AL	14	KCS	Direct	YC, Soy Meal	
Marshall Durbin *	Waynesboro	MS	50	KCS	Direct	YC, Soy Meal	
Peco Foods *	Bay Springs	MS	25	KCS	Direct	YC, Soy Meal	Y
Peco Foods *	Philadelphia	MS	20	KCS	Direct	YC, Soy Meal	
Peco Foods *	Sebastopol	MS	21	KCS	Direct	YC, Soy Meal	
Tyson Foods *	Union	MS	75	KCS	Direct	YC, Soy Meal	Y
Koch Foods *	Morton	MS	35	KCS	Direct	YC, Soy Meal	Y
H J Baker	Forest	MS	25	KCS	Direct	Ruminant Proteins, Poultry Meal	
Lady Forest Farms *	Forest	MS	6	KCS	Direct	YC, Soy Meal	
Calmaine *	Edwards	MS	5	KCS	Direct	YC, Soy Meal	
Purina *	Shreveport	LA	10	KCS	Direct	YC, Soy Meal, Barley, Oats	Y
Purina *	Macon	MS	5	KCS	Direct	YC, Soy Meal	
Pilgrim's Pride *	Arcadia	LA	75	KCS	Direct	YC, Soy Meal	Y
House of Raeford *	Choudrant	LA	30	KCS	Direct	YC, Soy Meal	
ADM	Reserve	LA	100	CN	Reserve, LA	HRW, SRW, YC, Sbns, Sorghum	
Cargill	Reserve	LA	100	CN	Reserve, LA	HRW, SRW, YC, Sbns, Sorghum	
Pilgrim's Pride *	Pittsburg	TX	100	KCS	Direct	YC, Soy Meal	Y
Northeast Texas Farmers *	Sulphur Springs	TX	5	KCS	Direct	YC, Soy Meal, Midds, Oats, Barley, DDG's	
Northeast Texas Farmers	Greenville	TX	11	KCS	Direct	YC, Soy Meal, Midds, Oats, Barley, DDG's	
Pilgrim's Pride *	Many	LA	50	KCS	Direct	YC, Soy Meal	Y
Louis Dreyfus	Beaumont	TX	110	KCS	Direct	HRW, SRW, YC, Sbns, Sorghum	
Frank Bailey Grain	Corpus Christi	TX	33	KCS	Direct	Sbns, YC, Sirghum, HRW	
ADM	Corpus Christi	TX	110	CCPN	Corpus Christi, TX	HRW, SRW, YC, Sbns, Sorghum	

* Feed Mill

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EXHIBIT A

REBUTTAL VERIFIED STATEMENT OF MICHAEL R. BILOVESKY

Exhibit 2: 2007 KCMO KCS-ICE [redacted] Northbound/Southbound Traffic

Woodward

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EXHIBIT B

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REBUTTAL VERIFIED STATEMENT OF GEORGE C. WOODWARD

My name is George C. Woodward. I am an independent management consultant with expertise in railroad transportation. My business address is 8318 St. Martins Lane, Philadelphia, PA 19118. My qualifications and experience are set forth in the Verified Statement I submitted in this proceeding on March 4, 2008. The purpose of my Rebuttal Verified Statement is to respond to certain issues presented by the Applicants[1] in their "Response to Comments and Requests for Conditions and Rebuttal in Support of Application" ("Reply") as that filing addresses the merits of the conditions that The Kansas City Southern Railway Company

[1] In this statement, I will use acronyms and terms such as "Applicants," as they have been used by Canadian Pacific Railway Company ("CPR"); SOO Line Holding Company ("SOO Holding"); Dakota, Minnesota & Eastern Railroad Corporation ("DM&E"); and Iowa, Chicago & Eastern Railroad Corporation ("IC&E") throughout the STB Finance Docket No. 35081 proceeding. I will also refer to DM&E and IC&E, collectively, as "DME," just as was done in the Application.

("KCSR") has requested the Surface Transportation Board ("STB") to impose if it grants the Application.

My Rebuttal Verified Statement will address three main points in response to the evidence and argument advanced by Applicants in their Reply. First, I will show that, despite Applicants' efforts to downplay the strategic significance of the interline traffic relationship between CPR and the Union Pacific Railroad Company ("UP"), the evidence clearly demonstrates that this partnership is unique among CPR's interline relationships. This close and burgeoning CPR-UP partnership does, and will continue to, influence the flow of traffic to and from points on CPR's system and the competitive routing options that CPR and UP provide to shippers. As I will explain, it is for that reason that the STB must take care to assess the impact of the proposed Transaction in light of the close and growing interplay between CPR and UP and the likelihood that this unique interline relationship will influence the post-Transaction flow of traffic to and from points on DME.

In addition, my Rebuttal Verified Statement will reinforce the evidence that I have previously offered (and which has been challenged by Applicants) that CPR and UP separately and collectively have an economic interest in routing as much corn as possible from DME origins to export facilities in the Pacific Northwest ("PNW"), to the detriment of KCSR-served receivers of corn. Finally, I will rebut Applicants' evidence and argument against KCSR's position that the so-called "Chicago Agreement," whereby KCSR-served shippers could enjoy access to the Chicago gateway via IC&E's Kansas City-Chicago line, must be preserved (as appropriately modified) as an important mechanism to promote competition in NAFTA-oriented traffic flows between Laredo and Chicago and to moderate the competitive behavior due to the CPR-UP partnership and UP's dominance of NAFTA traffic. My Rebuttal Verified Statement will once again demonstrate that KCSR's request for limited and specific STB-imposed conditions as outlined in KCSR's March 4 Comments are appropriate and necessary.

I. THE CPR-UP ALLIANCE IS A UNIQUE INTERLINE RELATIONSHIP, HAS INFLUENCED TRAFFIC FLOWS TO AND FROM CPR POINTS AND WILL ALSO AFFECT DME TRAFFIC FLOWS

KCSR previously has expressed its concern regarding the proposed Transaction's potential anticompetitive impact to the routing of corn traffic and upon all types of traffic routed in the Laredo-Chicago NAFTA corridor. In its Comments, KCSR has also pointed out that the potential impact of the proposed Transaction must be evaluated in light of the close strategic relationship between CPR and UP that will influence CPR's decisions with respect to post-Transaction pricing and routing of DME traffic. The Applicants' position in this proceeding, however, contradicts the descriptions of the CPR-UP alliance that both CPR and UP have made in public. What is more, the traffic data that I have analyzed shows that CPR interline traffic flows reflect an overwhelming strategic preference for UP interline options that is very likely to translate into a comparable shift in DME traffic flows away from KCSR.

In their Reply, the Applicants strenuously deny the existence of a "multi-faceted" CPR-UP "alliance" (despite CPR's use of the term "alliance" in its promotional materials) pursuant to which CPR and UP have a strong incentive to work with one another in preference to other connections. The Applicants further contend that the interline traffic relationship between CPR and UP (which is currently manifested in three "Can-Am" service programs) is but one of many allegedly indistinguishable interline relationships that CPR has with connecting Class I railroads.

The Applicants' claim is does not comport with the facts. In reality, the Can-Am alliance forged by CPR and UP is unique among CPR's service packages. My research reflects CPR's remarkable commitment to moving traffic in partnership with UP In fact, the traffic data reveals that the CPR-UP commitment to the Can-Am alliance overshadows all of CPR's other interline relationships and shapes the way that CPR interline traffic moves.

In their Reply, the Applicants offer for the first time the [[redacted]][2] underlying the Can-Am service, which Applicants contend disproves the existence of any CPR-UP alliance. [[redacted]]

In fact, this traffic alliance has enabled CPR-UP interline traffic to grow to much greater volume levels than has CPR's interline traffic with any other U.S. Class I railroad. Specifically, since 2001, CPR-UP [[redacted]] It should also be noted that one of the characteristics of the Can-Am alliance is that "CPR and UP marketing teams work together to solicit business for the three CanAm services." CPR-14/DME 14, Reply V.S. Milloy at 4. For marketing purposes, the services offered by CPR and UP in

2 [[redacted]]

these corridors effectively constitute the entirety of both railroad's systems. I question how CPR can insist that it has no preferred strategic relationship with UP, when CPR expects its marketing teams to work with UP under the banner of Can-Am service to solicit business that could in many cases be routed in partnership with other railroads under the banner of Can-Am service. Although CPR lists numerous other service-enhancing undertakings with interline partners other than UP as evidence that the Can-Am alliance is not "exclusive," never does CPR indicate that those initiatives are accompanied by the joint efforts of both carriers' marketing departments which includes, [[redacted]]

Attached as Exhibit 1 is a graphic depiction of the comparative growth for CPR interline traffic with UP and for CPR interline traffic with all other U.S. based Class I carriers between 2001 and 2006. Exhibit 1 shows that CPR-UP interline traffic volume is now larger than CPR's interline traffic volume with its other U.S. Class I connections. It is noteworthy that the CPR-UP volume grew at a [[redacted]] CAGR compared to a CPR-BNSF CAGR growth rate of only [[redacted]] during the same period. This reflects the uniqueness of CPR's preferred relationship with UP and belies Applicants' claim that the Can-Am alliance is really no different than any of CPR's other interline relationships.

Exhibit 1: Strong Growth of CPR-UP Interline Traffic Volumes 2001-2006

Moreover, my traffic data analysis confirms that the [[redacted]] is as comprehensive and pervasive as could be possible, given the network structure of the combined CPR and UP systems. Under their alliance, CPR and UP cooperate in the movement of virtually all traffic (including intermodal traffic which is all routed through Chicago) from virtually every

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REBUTTAL VERIFIED STATEMENT OF GEORGE C. WOODWARD

Exhibit 1: Strong Growth of CPR-UP Interline Traffic Volumes 2001-2006

REDACTED

CPR-served region of Canada and the U.S.[3] Attached Exhibit 2 shows how the Can-Am alliance shapes interline service between CPR and UP.

Exhibit 2: CP-UP [[redacted]] and comprehensive region map

As the map in Exhibit 2 indicates, [[redacted]] provide CPR and UP with significant and potentially more lucrative long-haul routing options through three specified CPR-UP interchange gateways: [[redacted]]. By channeling CPR-UP interline traffic through these gateways, CPR and UP have concentrated their interline route structure and traffic densities to maximize the benefits of the [[redacted]] and discourage other competitive routing options. A collateral impact of this arrangement may well be that both CPR and UP have diminished the frequency of service and/or capacity to move traffic through other gateways with other carriers, thereby eroding the effectiveness of CPR's interline service options with carriers other than UP. In fact, such collateral effects of the [[redacted]] may be reflected in the traffic growth data in Exhibit 1, above, because some of the dramatic CPR-UP interline traffic growth is likely to have been the result of traffic diversions away from interline routings that compete with CPR-UP interline routings. The previously noted much smaller rate of CPR-BNSF interline traffic growth is particularly significant.

[3] CPR's Corporate Fact Book for 2006 depicts the CPR-UP Alliance as offering a "seamless service" to CPR and UP customers, and states that "Joint CPR/UP teams oversee the operations of the Can-Am corridors and make strategic decisions with respect to operations, marketing, technology, and investment." Canadian Pacific Railway 2006 Corporate Profile and Fact Book at 44 (see my original Verifics Statement at 7 n. 6). This statement belies the notion that the Can-Am alliance is merely an initiative designed to accomplish greater interline efficiencies. The other operational "co-production" agreements mentioned in the CPR Annual Corporate fact book are specific corridors involving largely operational conveniences (such as the CPR-NS and CPR-CN arrangements for specific corridors and interchanges). No agreement that CPR has described provides for such a comprehensive commercial and operating agreement as the CPR-UP Alliance.

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Exhibit 2: CP-UP [[redacted]] and comprehensive region map

REDACTED

To my knowledge, the CPR-UP alliance, which derives from the [[redacted]] has never before been evaluated by the STB, and so its long-term impact on rail competition in the U.S. has not been assessed. But the traffic volume growth trends revealed in my analysis show that the CPR-UP alliance will serve as a backdrop against which CPR will analyze and modify DME traffic pricing and routings, and against which CPR will shape its post-Transaction relationship with KCSR. And, as I will explain in the following sections of my Rebuttal Verified Statement, the CPR-UP relationship will harm KCSR-served domestic corn receivers and, more generally, competition in NAFTA corridor service.

By all appearances, the [[redacted]], extend to shippers and receivers in the U.S. and Canada virtually seamless service between CP-served points and UP-served points as depicted in the map attached as Exhibit 2. Moreover, because one of the stated purposes of these agreements is to [[redacted]], one can fairly infer that the CPR-UP marketing teams that the Applicants have referred to apply differential pricing techniques to encourage CPR-UP traffic routings and to discourage alternative CPR and UP routings with other carriers.

Exhibit 3: CP-UP interline traffic flow map

Exhibit 3 illustrates the 2006 interline traffic flows between the CPR and UP systems and the specific routes over which CPR-UP interline traffic is moving. Particularly noteworthy are the significant CPR volumes interchanged to UP at [[redacted]] for destinations including the PNW grain export markets. Also among the things that Exhibit 3 reveals is that certain CPR-UP interline traffic may be subjected to considerable [[redacted]]

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Exhibit 3: CP-UP interline traffic flow map

REDACTED

Exhibit 4a: Example of Circuity CP-UP [[redacted]]

Exhibit 4a shows that traffic originating on CPR lines in [[redacted]]. A comparative review of the CPR-UP routes via [[redacted]] versus comparable CPR-BNSF routes via [[redacted]] reveals that the CPR-UP route is [[redacted]] more circuitous.

Exhibit 4b: CP traffic-CP Region 5 [[redacted]]

Moreover, my review of the traffic data reveals that [[redacted]] of the [redacted]] Exhibit 4b not only depicts the comparative circuitry of the CPR-UP route, but also shows the [[redacted]] Exhibit 4b also shows subject traffic routed through [[redacted]] underscoring the circuity that CPR-UP will incur to provide preferred partnership interline traffic within the CPR-UP traffic alliance. Exhibit 4b dramatically illustrates CPR's and UP's respective commitments to the [[redacted]] and the agreements' impact on the marketing and routing preferences of both carriers.

Yet another, and more salient, example of CPR's commitment to its UP alliance partner can be seen in transportation of CPR/former SOO-originated U.S. corn.[4] As the attached Exhibit 5 shows, based upon the CPR 100% Grain 2005 traffic data, [[redacted]

[4] By the term "CPR/SOO-originated corn," I am referring to corn that originates on CPR's former SOO network of lines in Minnesota and North Dakota.

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Exhibit 4a: Example of Circuitry CP-UP [[redacted]]

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Exhibit 4b: CP traffic-CP Region 5 [[redacted]]

REDACTED

[redacted]], and all of that corn was handled in CPR-UP interline service despite the availability of a comparable CPR-BNSF interline alternative.[5]

Exhibit 5: Corn from CPR/SOO origins

Exhibit 5 shows that CPR/SOO originated [[redacted]] carloads of corn in 2005 according to CPR's 100% grain data, and of that [[redacted]] carloads [[redacted]] were forwarded to the UP at [[redacted]] for export through Seattle, Tacoma and Kalama[6] [([redacted]] Exhibit 5 also shows that, in 2005, no CPR/SOO corn was handled in interline service with [[redacted]] regardless of the destination.

As with the other examples I have provided, CPR's actions speak louder than its words – the CPR-UP alliance clearly shapes the manner in which CPR/SOO corn is routed to PNW markets, just as is the case with other CPR interline traffic flows. CPR thus has shown that it can and will differentially price corn traffic to specific markets that it perceives to be the most lucrative. Given CPR's existing propensity to route corn to PNW export markets in coordination with its UP alliance partner, KCSR-served domestic receivers of corn in the south-central U.S. have good reason to be concerned about their continued access to DME corn origins, as I will discuss in the section immediately following, unless the STB properly conditions approval of the

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5 [[redacted]] See Reply V.S. Milloy at 5.

6 "As the Application indicates, approximately 95 percent of the corn presently originated by CPR in the United States does move to PNW export terminals." Applicants' Reply, Reply Verified Statement of Don Smith ("Reply V.S. Smith") at 3 (citing Application, Exh. 12, Market Analysis at 8).

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Exhibit 5: Corn from CPR/SOO origins

REDACTED

Application upon a permanent extension the KCS-IC&E Grain Agreement (as appropriately modified to provide more stringent service standards and penalties).

II. CPR WILL HAVE AN ECONOMIC INCENTIVE TO DIVERT DME DOMESTIC CORN TRAFFIC TO PNW EXPORT MARKETS

In my previous Verified Statement, I offered detailed evidence to show that CPR will have a strong economic incentive to route DME corn traffic to PNW markets wherever possible. In support of that proposition, I provided data showing the comparatively higher revenue and net contribution that rail carriers gain when routing Midwestern corn to PNW export facilities. My testimony was reinforced by that of Mr. Thad Jones, who explained in his Verified Statement in support of KCSR's Comments that market trends and pricing factors (explained in terms of "spreads") reflected strong PNW export corn demand that is expanding the corn-producing territory from which such demand may be satisfied. In short, the evidence shows that PNW export demand is reaching to progressively more distant corn sources, particularly as overall demand for corn grows. The Applicants' submission supports this forecast of strong future demand for corn as food/feedstock in their [redacted]] This underscores the economic incentive that CPR will have to divert corn into lucrative, long haul, higher margin food/feedstock export markets through PNW export."[7]

Applicants have challenged my revenue and contribution analysis, offering new evidence of their own to indicate that, despite the existence of the [[redacted]

7 [[redacted]]

[redacted].][8] CPR would have no economic incentive to route DME corn to the PNW via UP (or with any other carrier or carriers for that matter).[9] The Applicants claim that it would not be feasible for the combined CPR/DME system to divert corn to the PNW for export, insisting that the interline routes under which such corn traffic might move are too circuitous and/or inefficient to warrant diversion away from existing IC&E/KCSR interline service to domestic consumers in the U.S. As I will show in the discussion immediately following, the Applicants' evidence and arguments on this subject are incomplete, incorrect, and premised on faulty and inconsistent costing analysis. In so doing, my evidence will confirm that CPR will have considerable economic incentive to route as much DME-origin corn as possible to the PNW after implementation of the Transaction to the detriment of KCSR-served domestic receivers of corn.

Exhibit 6a: Corn Origin Locations and Volumes on CPR(SOO) and DME/ICE

To demonstrate the feasibility of diversions of DME corn away from domestic consumers such as those served by KCSR to PNW export markets, I begin by offering an illustrative comparison of the locations of similarly situated corn carload origins on CPR/SOO and on DME. Exhibit 6a, which shows the corn loading locations on CPR/SOO and the carload volumes originated at each such location, and the same data with respect to corn-loading facilities on

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[8] As if to imply that the door is closed to modification of the [[redacted]] Reply V.S. Smith at 5. On the other hand, given the contribution potential for such traffic, which I will discuss in detail below, it is at least as likely that UP would readily agree to such an amendment.

[9] On the one hand, the Applicants maintain that it is simply not practical for CPR to route more DME corn to PNW export markets post-Transaction. Ironically, it appears that corn shippers supporting the proposed Transaction anticipate that one possible benefit of the Transaction for them would be more efficient access to PNW markets.

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Exhibit 6a: Corn Origin Locations and Volumes on CPR(SOO) and DME/ICE

REDACTED

DME. Exhibit 6a demonstrates the geographical proximity of current corn origins on CPR/SOO and DME.

Exhibit 6b provides a route map comparison of the mileages for representative CPR/SOO and DME origin corn current and potential routes to the PNW via the UP/Kingsgate gateway and the current DME/BNSF route. It should be noted that DME origin corn to BNSF for PNW export is a significant existing traffic flow.

Exhibit 6b: Route map comparison -CPR(SOO) and DME/ICE corn origins-PNW

Drawing on the traffic data illustrated in Exhibit 6a, I have provided a relative revenue and contribution analysis of both average and specific representative DME corn loading origins to existing and potential destinations to demonstrate the relative economics for the transportation of corn in CPR/DME-UP interline service to the PNW. Having selected specific representative origins in this fashion, I then developed the appropriate relative revenue and cost projections associated with current and potential movements. The specific relative revenue, cost, and contribution estimates are set forth in Exhibit 7a.

Exhibit 7a: Contribution Analysis with Specific Representative Examples

It is important to note that the analysis is designed to show relative profitability using comparable cost inputs to the hypothetical STB Uniform Rail Costing System ("URCS") model. Thus identical train size, net weights, car types, commodity and unit train indicators were used for all movements. While it is recognized that the URCS costing system is an average costing system, it is well suited for the current comparative analysis to show relative profitability among a number of markets where CPR might choose to price its services and deploy transportation assets post-transaction. It is not intended to suggest that the STB's URCS hypothetical cost estimates have quantified the precise cost and contribution levels but they provide insight into

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Exhibit 6b: Route map comparison -CPR(SOO) and DME/ICE corn origins-PNW

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CPR's future commercial and pricing options to maximize its revenue and contribution assuming DME is a commercially-integrated part of the CPR system. It also assumes that all the movement options will achieve (over time) the productivity levels reflected in the comparable cost inputs.

The specific examples selected in Exhibit 7a once again support the premise of my original Verified Statement – that CPR will have a strong economic incentive to divert as much DME corn as possible to UP-served PNW export terminals (and away from KCSR-served domestic receivers of corn) due to the greater per car revenue and contribution that CPR will enjoy in so doing.

·Exhibit 7a is a more precise and accurate estimate of the revenue, cost, and contribution for specific representative examples than the evidence I had supplied earlier in Exhibit 7 to my original Verified Statement. The Exhibit 7 of my original Verified Statement, however, reflected a more generalized calculation of average contribution using all subject traffic on particular carriers in the specific markets. Because my original comparative analysis was heavily scrutinized in the Applicants' reply, I have decided to offer an even more precise, point-specific presentation of the relative specific representative revenues, costs, and contribution in the Exhibits 7a.[10]

Exhibit 7a provides estimated specific representative revenue, cost, and contribution for four "STB URCS hypothetically modeled" corn movements as follows: (1) an existing corn

[10] Thus, for example, while I had stated an average per-car contribution of [[redacted]] to DME for corn traffic moving pursuant to the Grain Agreement, I have discovered that IC&E's per contribution on corn traffic routed under the Grain Agreement from Minnesota Lake, MN (an actual loading point on IC&E from which KCSR-served shippers acquire corn) to Waldron, AR is actually [[redacted]] Although I would accept that there may be some IC&E-KCSR Grain Agreement traffic for which IC&E may be earning contribution of [$[redacted]] (as I had previously calculated), it is clear that, for some IC&E origins at least, the Grain Agreement contribution may be actually less.[10]

traffic flow from a specific IC&E origin to a specific KCSR destination in the south-central U.S.; (2) an existing corn traffic flow from a specific DM&E origin to the PNW via BNSF interchange;[11] (3) an existing corn traffic flow from a specific CPR/SOO origin to the PNW via UP interchange at Kingsgate/ Eastport; and (4) a hypothetical post-Transaction move of IC&E corn from a point from which current KCSR-destined corn originates to the PNW via UP interchange at Kingsgate/Eastport. Exhibit 7a, in which I have applied hypothetical URCS costs for each move (including, where required, to the Canadian portion of the move) reflects the specific relative contribution opportunities for specific representative traffic movements. It is especially useful to compare the post-Transaction contribution opportunities available to CPR for corn traffic moving from Minnesota Lake, MN to the PNW versus to KCSR-served destinations in the south-central U.S. Exhibit 7b extracts the CP revenue and contribution estimates for these four specific representative examples to show the greater revenue and contribution possible for CP post-transaction to divert corn to the PNW export markets that was formerly forwarded to KCSR served domestic receivers.

Exhibit 7b: CP/DME/ICE Revenue & Contribution per Car for Corn Traffic-PNW

I have also supplied average revenue, cost, and contribution analysis for average movements for each of the four subject traffic segments. In Exhibit 7c below it is seen that a similar conclusion is reached that current DME corn in shorter haul markets will show increased revenue and contribution when diverted to longer haul PNW export markets.

[11] My traffic analysis reveals that there are DM&E-served elevators in [[redacted]] from which DM&E is currently moving corn to the PNW via interchange with BNSF that are only 152 rail miles (and only 40 highway miles) from IC&E-served elevators in [[redacted]] that currently supply corn to KCSR-served domestic receivers. This proximity underscores the potential for post-Transaction corn diversions away from KCSR served domestic receivers of corn.

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Exhibit 7b: CP/DME/ICE Revenue & Contribution per Car for Corn Traffic-PNW

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Exhibit 7c: Average Revenue and Contribution (Relevant Origins-Destinations)

To illustrate the significant increase possible for average CPR revenue and contribution associated with the diversion of corn traffic from former DME-KCSR flows to PNW export markets I have shown the CPR revenue and contribution for the average traffic flows below in Exhibit 7d. Comparable URCS costing inputs were used for all the traffic segments similar to the earlier specific examples.

Exhibit 7d: Average CP/DME/ICE Revenue-Contribution per Car-Corn to PNW

While it is recognized that a CPR "ideal world" scenario providing for CPR single line service to Vancouver for corn export is not available in the near term,[12] the [[redacted]] quite clearly provide an economically attractive longer haul routing option for CPR, in accordance with which CPR would interchange corn with UP at the Kingsgate/Eastport gateway for final transport by UP to export facilities in Seattle, Tacoma and Kalama, Washington.[13] Exhibit 3, above, illustrates the importance of CPR/SOO-originated export corn to the CPR-UP interline traffic alliance The combination of the CPR-UP traffic alliance and the

[12] In fact, my analysis here supports the assertions contained in my original Verified Statement that it would be to CPR's ultimate advantage (port capacity and political issues notwithstanding) to route CPR/SOO and CPR/DME corn to CPR-served terminals in Vancouver. Although no Vancouver terminals currently may exist to facilitate the export of corn, CPR will have acquired a far more expansive network of corn-gathering lines that could serve as an incentive to develop the necessary corn export infrastructure in Vancouver that would enable CPR to maximize its contribution opportunity.

[13] The Applicants maintain that, even if it were in CPR's economic best interest to maximize its profits by routing more corn in interline service with UP, the [[redacted]] It is not entirely clear why UP has included such capacity restrictions in the agreement, but it is quite possible that they may reflect current UP capacity constraints. If so, the potential contribution from increased export corn traffic moving via this route and other opportunities presented to UP as a consequence of the proposed Transaction could very easily result in a revised [[redacted]] allowing for additional corn traffic

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Exhibit 7c: Average Revenue and Contribution (Relevant Origins-Destinations)

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Exhibit 7d: Average CP/DME/ICE Revenue-Contribution per Car-Corn to PNW

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benefits of higher overall revenue and contribution on PNW export corn traffic as shown in Exhibit 7d (above) prove once again that CPR would have a powerful incentive to divert as much DME corn traffic as it can to UP-served PNW export terminals, to the detriment of KCSR-served corn receivers.

The Applicants' dispute with my diversion analysis revolves around two issues – the contribution potential for diverting DME corn traffic to PNW export (which the Applicants contend is not there, even though substantial volumes of similarly-situated DME-originated corn are interchanged to BNSF for PNW export), and the circuity of the routes by which CPR would have to route DME corn to reach Kingsgate/Eastport. As I will show, the Applicants have seriously overstated the estimated service costs associated with CPR-UP PNW traffic routings, and, in turn, significantly understate the contribution potential. I will also show thereby that the circuity issue the Applicants have raised is irrelevant based on my contribution evidence.

I find it very interesting that, although the Applicant's costing witness, Mr. John H. Williams, provides numerous tables with corn traffic flows and per-unit revenues, he never applies hypothetical URCS costs to determine the contribution that participating railroads earn from such movements. The persistent absence of URCS-based costs per car-mile and the attendant lack of contribution estimates in Mr. William's tables are most conspicuous in Attachment JHW-13 ("Corn Terminated At Pacific Northwest Ports in 2005") to his Rebuttal Verified Statement. By applying URCS-based contribution estimates to this 2005 Carload Waybill Sample Data, Mr. Williams could have shown how per car contribution on PNW corn movements compared to 2005 contribution estimates on other corn terminations presented in other Williams attachments. He did not, likely because the result would have disproved his thesis.

Mr. Williams is also incorrect when he states that the "STB Railroad Movement Cost Program for URCS costs is a model maintained by ALK (and purportedly, resembles the STB's URCS cost.)" I have relied on the STB's own proprietary hypothetical costing model to determine the estimated costs and contribution associated with the subject movements. The STB's hypothetical costing model is not maintained by ALK and is available to any interested party (including Mr. Williams.)

More importantly, Mr. Williams' Canadian costing analysis (which he attempts to apply to the portion of CPR's movement of CPR/SOO-originated corn delivered to UP at Kingsgate/Eastport) is inappropriate to a relative contribution analysis where every attempt is made to provide a hypothetical "level playing field" in which to assess the relative revenue and profitability of CPR's future commercial pricing and routing options, and shows the inherent problems with using the Canadian cost model he has employed. If CPR's Canadian operating costs were as Mr. Williams alleges, then it would follow that current CPR/SOO corn movements in interline service with UP via Kingsgate/Eastport would have a decidedly marginal contribution margin of [[redacted]]. In fact the CPR/SOO corn movements are part of the largest CPR-UP interline traffic flow through the Kingsgate/Eastport interchange as illustrated on Exhibit 3.

In my view, Mr. Williams has erred in attempting to mix two very different costing models in the same traffic flow; thus undercutting the common costing assumptions needed for an appropriate relative contribution analysis. The STB's URCS costing model is a long-term variable costing model with specific Class I carrier inputs. It also provides for Western Carrier Average costing calculations where a carrier's costs may not be represented by a Class I carrier. For example, DME costs are not in the URCS costing output, but the Western U.S. average costs provide an appropriate long-term estimate of the DME costs when integrated into a Class I carrier such as CPR, although it would also be appropriate to apply CPR/SOO URCS costs to DME to measure the post-Transaction costs of DME traffic movements. While the Canadian costing model used by Mr. Williams appears to have none of this functionality, more importantly it appears to introduce a significantly different costing allocation scheme whose output cost levels on an average cost per car-mile are significantly different from URCS costs. As I show in Exhibit 8 the URCS costing model produces (as expected) comparable costs per car-mile as a function of length of haul for different carriers and the Western Average.

Exhibit 8: URCS and ARCM cost per car-mile vs. Length of Haul

The purpose of the relative revenue and contribution analysis in Exhibit 7b is to provide insight into the future CPR decision process once they have numerous current and potential markets among which to encourage and discourage the transportation of corn (including both domestic and export markets) using a comparable costing basis.

I disagree with Mr. Williams' use of the so-called Canadian ARCM costing model to provide costs for the [[redacted]] mile intermediate portion (i.e., between Portal, ND, and Kingsgate/Eastport, ID) of a DME/CPR-UP line-haul move between IC&E corn origin points and UP-served destination points in the PNW. This costing model – the Canadian Transportation Agency's "Agency Regulatory Costing Model" ("ARCM") – appears, as I have stated, to have a significantly different cost allocation method and may include different fixed and variable allocation schemes, different costs of capital and other differences in methodology that make it inappropriate to "mix" costing system outputs in a relative contribution analysis

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involving multiple traffic flows. I also note that URCS is the only approved costing model for use in STB proceedings, even for moves that take place in a foreign country.[14]

The underlying premise of the Applicants' use of ARCM is that it should be used simply because it is a *Canadian* model, but Mr. Williams makes no attempt to compare it to URCS or to explain the differences in the inputs between the two costing models. Also, I do not recall Mr. Williams ever professing to be experienced in the use of the ARCM costing model.[15] As Exhibit 8 shows, the URCS and ARCM costing models produce significantly different outputs for similarly situated length of haul traffic. A single consistent costing model is more appropriate for a relative cost and contribution analysis and Exhibit 8 demonstrates that the [[redacted]] cost output from the ARCM model for the CP move between Portal, ND, and Eastport, ID from that Mr. Williams is suggesting in Attachment JHW-14 is far out of the range of the URCS costs produced for similarly situated traffic for any western rail carrier. The inappropriate insertion of an unrealistic ARCM cost into an otherwise URCS comprehensive cost analysis is the fatal flaw in Mr. Williams assertion that sufficient potential contribution margin is unavailable to support the diversion of DME(ICE) corn traffic to PNW export markets.

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[14] Simplified Standards For Rail Rate Cases, STB Ex Parte No. 646 (Sub-No. 1) at 100 (STB served Sept. 5, 2007("We conclude that our simplified proposal will apply fully to cross-border traffic.[fn] For the Canadian portion of a movement, we will use the URCS data for its U.S. subsidiary to estimate the operating costs for the entire movement. Similarly, for the Mexican portion of a movement, we will use the URCS data for its U.S. counterpart, where available, or regional URCS otherwise.").

[15] Mr. Williams, baldly asserts that the ARCM's "costs are the equivalent of URCS costs for Canadian regulatory purposes." Applicants Reply, Reply V.S. Williams at 13. Mr. Williams does not profess to be an expert in the use of ARCM, does not explain for what sort of "regulatory purposes" ARCM is applied, and nowhere demonstrates how ARCM is similar to, or how it differs from, URCS. We are expected to take Mr. Williams' word for it. As it turns out, the costing models do have some evident quantitative differences.

CPR offers no evidence to prove that ARCM has been, or could be, used in a fashion identical or even comparable to URCS as Mr. Williams proposes to use it here. I do not claim to be proficient with ARCM, cannot tell whether ARCM has been used "for Canadian regulatory purposes" in the manner in which it has been applied here by the Applicants, and find very little information in the filed evidence or in Mr. Williams' workpapers (which have not been introduced into the record) to be able to confirm that ARCM has been used properly or for a suitable purpose in this case. What I can tell, however, is that the ARCM per car-mile average cost for CPR's movement of corn across Canada (i.e., from Portal, ND, to Kingsgate, BC/Eastport, ID) is significantly higher than URCS cots for similar traffic. Specifically, the distance from Portal to Kingsgate/Eastport is [[redacted]] miles. According to Mr. Williams, ARCM attributes the CPR cost to move corn over this portion to be [[redacted]] per car, resulting in a per car-mile cost of [[redacted]]. I have provided in Exhibit 8 a comparison of this ARCM-derived cost to the URCS costs associated with the specific movements analyzed in Exhibits 7a and 9a. That comparison indicates that ARCM is a non-comparable substitute for URCS, and that the use of this model by Mr. Williams is merely a flawed device to disprove my diversion analysis.

Because the Applicants have failed to show that ARCM is an accurate, reliable, and comparable counterpart to URCS for variable cost purposes, URCS is a far better measure of railroad variable costs from which relative contribution for the various movements should be calculated. Accordingly, my costing and contribution evidence as set forth is far more accurate and credible than is Mr. Williams' competing evidence on behalf of the Applicants.

In addition to Mr. Williams' application of ARCM being suspect, his use of URCS costs is inconsistent as well. To begin with, Mr. Williams states at Reply V.S. Williams, Attachment JHW-14 (page 1) that [redacted][16] Mr. Williams' contribution estimate appears to be significantly understated, especially in light of my evidence in Exhibit 7a, above, showing, for example, that [redacted][17] I suspect that the unusually low contribution for the CPR/SOO move is attributed to the overstated costs involved in applying ARCM to the portion of the Oakes-PNW through route that passes through Canada.[18]

In fact, it appears that, to produce positive contribution on CPR's exiting PNW corn traffic while applying ARCM on the Canadian segment of such a move, Mr. Williams may have made questionable (and ultimately inconsistent) adjustments to the URCS costs [redacted] Specifically, in his Reply V.S. Williams, Attachment JHW-14 (page 1), Mr. Williams provides a cost and contribution estimate for a CPR-UP movement of corn from Glenwood, MN to Seattle, in which he provides URCS costs for CPR's U.S. portion of the movement from Glenwood, MN,

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16 [redacted]

17 The examples of rates for corn traffic to the PNW included in Mr. Williams' statement (See Reply V.S. Williams, Attachment JHW-14, page 2), [redacted]

18 In light of my more thorough assessment of rail rates and contribution for corn flows to export facilities in the PNW, I find it difficult to believe that, according to Mr. Williams' estimates (in which he applies ARCM, of course), [redacted]

to Portal, ND, and ARCM costs from Portal, ND, to Eastport, ID (the interchange point with UP). CPR's Glenwood-Portal route is about [[redacted]]. Mr. Williams estimates URCS costs for this portion of the move at [[redacted]]

[[redacted]] to Portal does not square with the URCS cost estimates that Mr. Williams then applies to hypothetical post-Transaction movements of corn from IC&E origins to the PNW. In his Attachment JHW-14 (page 2), for example, [[redacted]] Here, as with his other examples, Mr. Williams applies ARCM to the Canadian component of the route [[redacted]] The Winnebago-Portal mileage over a post-Transaction CPR route (via Minnesota City – the route over which the Applicants themselves have insisted that this traffic must move) is [[redacted]] Accordingly, Mr. Williams' per car-mile URCS costs for Winnebago-Portal are a little more than [[redacted]] Mr. Williams fails anywhere to explain this discrepancy, and, indeed, I doubt he can without acknowledging a flaw in one or the other (or both) of his URCS cost components in Attachment JHW-14.[19]

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[19] If Mr. Williams had applied his [[redacted]]

All of the discussion immediately above confirms that Mr. Williams' application of ARCM and his inconsistent use of URCS are both highly suspect and entirely result-driven. For these reasons, the evidence in Mr. Williams' Attachment JHW-14 is fatally flawed and proves nothing, other than that ARCM is an inappropriate proxy for URCS when assessing the Canadian component of a through movement that both originates and terminates in the U.S. In light of this major shortcoming in ARCM, I have correctly relied upon URCS instead, which the evidence now shows to be a far more reliable proxy for comparable CPR variable costs than is ARCM. Applying the appropriate URCS costs instead of ARCM to the examples at page 2 of Attachment JHW-14, I show in Exhibits 9a and 9b (below) more reliable estimates of the considerable contribution that CPR would earn from diverting IC&E corn to the PNW.

Exhibits 9a & 9b: Restated & Corrected-Cost & Contribution Analysis JHW-14

Exhibit 9a (a restatement of JHW-14 with John William's original cost input assumptions) and Exhibit 9b (a correction of JHW-14 using the comparable cost input assumptions of my earlier Exhibits 7a, 7b, 7c and 7d) not only disprove Mr. Williams "negative contribution" hypothesis, but also give specific examples of how CPR would stand to gain more contribution per car post-Transaction by diverting corn from these sampled points to the PNW and away from KCSR-served destinations in the south-central U.S. Exhibit 9a and Exhibit 9b also dispel the theory that the route over which this traffic would move is too circuitous to be able to support a profitable service. (Again, for my costing purposes and relative contribution analysis, I have accepted the Applicants' statements about the routes and length of haul that IC&E corn from Iowa and Minnesota would have to be transported, and I still show ample contribution potential at competitive price levels that is higher than that which CPR would earn under movements to KCSR served domestic shippers governed by the Grain

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Agreement.) In short, the circuity argument that the Applicants have raised at various points in the Reply and supporting verified statements is a "red herring" when viewed in the context of the significant increase in revenue and contribution possible as illustrated in Exhibits 7a, 7b, 7c, 7d, 9a and 9b.

On a separate note, the Applicants' witnesses, Mr. Williams and Mr. Smith, claim that railroads seek to "diversify" their corn transportation business, implying, in essence, that service to a variety of corn-consuming destination markets is comparable to a diversified investment portfolio. See Applicants' Reply, Reply V.S. Williams at 7-10; Reply V.S. Smith at 7. (Mr. Williams infers the importance of a diversified corn transportation business from his review of the carload waybill sample, rather than on the basis of any specified economic principle.) Mr. Williams and Mr. Smith are correct by half. Railroads are indeed well served by possessing networks that enable them to offer service to a variety of potential destination markets, but they would be unwise to diversify their transportation business simply for the sake of "diversity." Rather, regardless of the availability of other markets, railroads, like any other profit-maximizing firms, focus on those components of their respective "portfolios" that provide the greatest profit opportunities. As I have shown, CPR's greatest corn transportation profit opportunity – both for its CPR/SOO corn (as reflected in current traffic flows) and for DME corn – lies in PNW export markets.[20]

But even if it were true that there is overarching value in corn traffic diversity, as Mr. Williams and Mr. Smith claim, then this philosophy would suggest that there is an incentive to

[20] Mr. Williams own supporting materials disprove the importance of "diversity." In particular, Attachment JHW-10 ("Corn Terminated by BNSF in 2005") of the Reply V.S. [redacted]]

route *more* DME corn traffic to the PNW, not less. Specifically, Mr. Williams' evidence reveals [[redacted]] Under this diversity theory, UP would have very strong incentive to enhance its PNW corn termination portfolio, and it would have very good reason to revisit the [[redacted]], especially since CPR-originated corn actually represents better than three-quarters of all UP-terminated corn moving to PNW export.

Although we disagree on most points, I do happen to agree with the Applicants in one important respect – increased ethanol production and its impact on demand for DME corn will play a significant role in shaping the future flows of such corn.[21] As the Applicants' witness Mr. Anderson states, corn now moving to DME-served elevators may shift to meet the growing demand of ethanol producers that are now, or will be, located within the general vicinity of these elevators. This increased local demand for corn is certain to drive corn prices upward (as will growing global demand for corn for human and livestock consumption.) Corn prices are projected by USDA to increase approximately 29% in 2008 over the average price levels in

21 [redacted]" Applicants' Reply, Reply Verified Statement of Lynn A. Anderson ("Reply V.S. Anderson" at 7-8, 11.]

2007.)[22] This, in turn, would diminish the impact of transportation costs on the overall delivered price of corn.

Corn use for ethanol production appears to explain the expanding "reach" of Asian corn demand to include DME corn that Applicants contend is too distant from export markets to be the target of economical long-haul opportunities. But the ethanol boom is not a unique issue for DME; it is instead an issue that confronts virtually every part of the so-called U.S. "corn belt." While ethanol producers' demand for corn may drive the price of corn upward, there is no evidence that world consumers will simply "exit the market" or will turn to other corn producing regions (unspecified by the Applicants or their witnesses) where ethanol producers are not a factor. In addition to the incentives to route DME corn to PNW export markets, CPR will also see opportunities in connection with sourcing corn as feedstock to the growing number of local ethanol production plants on DME lines. This "local diversion" of corn will also allow CPR a "second bite" at the traffic by routing much of the DME ethanol traffic to Eastern U.S. markets (New York, Philadelphia, New England) via CPR direct.

Exhibit 10: DME/ICE Ethanol Traffic flow map showing traffic potential CPR.

As international demand, ethanol feedstock requirements, and corn prices rise, CPR will have even more post-Transaction incentive to favor PNW export routes over service to KCSR-served corn receivers. Thus disadvantaged, KCSR's evidence shows that – (1) KCSR-served domestic corn receivers who have come to depend on IC&E originated corn will have to look elsewhere to satisfy their requirements, and (2) these KCSR served domestic feedlot customers may incur significantly higher prices and suffer supply disruptions unless approval of the

[22] "Corn Prices Will Remain in Record Territory" Wall Street Journal, May 10-11, 2008, page A-3.

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Exhibit 10: DME/ICE Ethanol Traffic flow map showing traffic potential CPR.

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Transaction is conditioned upon the permanent extension of the currently effective Grain Agreement as appropriately modified.

III. THE KCSR-IC&E RELATIONSHIP IS AN IMPORTANT (BUT THREATENED) SAFEGUARD IN ASSURING ROBUST COMPETITION IN THE LAREDO-CHICAGO NAFTA CORRIDOR

In my original Verified Statement, I explained that the so-called Chicago Agreement plays an important role in assuring rigorous competition in the Laredo-Chicago NAFTA corridor, and I stressed that, although no traffic currently moves pursuant to the agreement's terms, the agreement nevertheless is central to KCSR's ability to offer shippers a Laredo-Chicago service option (as an alternative to UP's single-line service) that would not otherwise exist. For these reasons, I stated that the STB should, as a condition to approval of the Application, require CPR to keep the Chicago Agreement in place and require CPR to negotiate modifications to that agreement to allow for the movement of all traffic under reasonable terms.

The Applicants contend that the Chicago Agreement is irrelevant in the context of the proposed Transaction, and that CPR's acquisition of control of DME will have no adverse impact on competition in NAFTA corridors. As I will explain below, the Applicants are far too dismissive of the importance of the relationship between KCSR and DME, and they gloss over the reality that, as a result of the Transaction, competition for Laredo-Chicago NAFTA traffic flows will be diminished.

A. CPR and UP have a vested interest in cooperating in the movement of NAFTA traffic, perpetuating UP's dominant market share

UP is by far the dominant rail carrier moving traffic between Laredo and Chicago, and the Can-Am alliance contributes to that dominance by specifically contemplating the movement of traffic between CPR-served points north and east of Chicago and UP-served destinations, including the Laredo gateway, through the Chicago interchange. Although CPR has other interline choices for routing traffic to and from Laredo, CPR has come to view UP's NAFTA service as CPR's primary means of access to Mexico, and it has said so publicly. CPR has stated that "nearly 90 percent of the rail traffic to and from Mexico in which CPR participates moves via Laredo (virtually all in conjunction with UP)," and it has also expressed concern that KCSR's "NAFTA Rail system" could potentially impair the "competing services offered by CPR and others (in conjunction with UP)" via the Laredo gateway. See CPR Comments and Additional Comments filed in connection with Kansas City Southern – Control – The Kansas City Southern Railway Company, Gateway Eastern Railway Company, and The Texas Mexican Railway Company, STB Finance Docket No. 34342, on September 2, 2003 and September 30, 2004.

To demonstrate the extent to which CPR and UP cooperate on NAFTA traffic flows through Chicago, I offer Exhibit 11, below. Exhibit 11 confirms the close partnership between CPR and UP in this service lane, and reflects the far more limited extent to which CPR traffic flows to and from Mexico rely on carriers other than UP.

Exhibit 11a: CP Traffic to Laredo/Eagle Pass by connecting carrier[23]

In sum, Exhibit 11a shows once again the close strategic ties between CPR and UP and their mutual commitment to the Can-Am alliance as manifested in the CPR-UP [[redacted]] In fact, the CPR-UP alliance simply increases the gathering and distribution traffic network to feed UP's dominant NAFTA market share. CPR, which amounts to a junior partner

[23] The Applicants state that Canadian National Railway ("CN") participates in more NAFTA traffic flows through Chicago than does CPR, by which they hope to mislead the STB about the importance of CPR-UP NAFTA traffic volumes. Consulting a rail network map shows that CPR and UP enjoy a very direct route between CPR-served points in the western Canadian provinces of Saskatchewan and Manitoba and the U.S. states of North Dakota and Minnesota and UP-served Mexican gateways via an interchange at Minneapolis-St. Paul (as prescribed in the 2000 Routing Agreement). CN does not enjoy such an efficient connection with UP at the Twin Cities, and so, it would appear that CN and UP find it more efficient to interchange traffic to Chicago instead.

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Exhibit 11a: CP Traffic to Laredo/Eagle Pass by connecting carrier

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in the CPR-UP alliance for NAFTA traffic to and from Mexico, benefits greatly from this strategic relationship because it is able to use the UP's existing NAFTA traffic flows as leverage for CPR's proposed control of DME by the use of a "totality" approach where CPR traffic may be bundled with UP traffic to create a broader contractual offering to customers.

Exhibit 11b: CP Traffic to Laredo/Eagle Pass flow map

In effect, CPR and UP would be "two railroads acting as one" as a UP marketing official has characterized the relationship. CPR and UP each can compensate for the competitive weaknesses of one partner with the other's competitive strengths. CPR traffic from Eastern U.S. origins might thus be contractually "tied" to other CPR and/or UP traffic flows to present a totality contract approach where a customer sees their competitive traffic flows "tied" to other non-competitive traffic. Exhibit 11a shows that to effectively implement this "totality" commercial strategy a larger competitive critical mass is necessary, hence the overarching strategic reason behind the CPR-UP traffic alliance.

While my traffic analysis shows that UP is the dominant carrier in Laredo-Chicago traffic movements, more importantly and for the purposes of this proceeding, it also shows that CPR is a willing participant in this dominance by routing its NAFTA traffic to and from Mexico via UP interchanges as prescribed under the [[redacted]]. CPR and UP both recognize the value of their respective shares of the NAFTA market and price traffic accordingly. Because UP holds the dominant position in the Chicago-Laredo NAFTA corridor and can use its overall network access to all other Mexican gateways as leverage, UP currently retains over [[redacted]] of all rail traffic moving between the U.S. and Mexico. It is not surprising therefore that CPR would agree to interchange the vast majority of its traffic to and from Mexico with UP as prescribed

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Exhibit 11b: CP Traffic to Laredo/Eagle Pass flow map

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under the [[redacted]] to enhance CPR's profit opportunities and potential for commercial "reciprocity" from UP.

Exhibit 12: CPR-UP Interline Traffic to Mexico price levels vs. other 2001-2006

Traffic volumes are not the only method by which UP's NAFTA market share can be assessed. Exhibit 12 shows that CP-UP price increases from 2001-2006 for rail traffic to and from Laredo/Eagle Pass have [[redacted]] for all other rail traffic in the U.S. during the same period. It is evident that UP can and does use its predominant market share in traffic to and from Mexico to extract higher revenues, but what is less obvious is that CPR is in a position indirectly to benefit from UP's dominant market share. Having established a close partnership with UP, CPR can secure its share of the increased prices associated with routing its own traffic via UP using UP's competitive route advantage to leverage the total price (including CPR's portion).

B. CPR will not work with KCSR to strengthen competitive alternatives to UP's dominant position in the movement of NAFTA traffic

Because KCSR lacks an independent route to Chicago, it has explored arrangements that would enable it to provide shippers with an alternative to UP's Laredo-Chicago service that would approximate as closely as possible UP's single-line service offerings. Although not heavily used for such purposes, KCSR and IC&E have been willing partners in an interline arrangement that offers a competitive alternative to UP's single-line service in the Laredo-Chicago NAFTA corridor, and this relationship is a constraint on UP's dominance in NAFTA traffic flows. In fact, the KCSR-IC&E relationship appears to be a natural. Joint participation in Laredo-Chicago NAFTA traffic via Kansas City enables both carriers to handle traffic that would move the lengths of their respective systems, and permits both to participate in growing trade flows. The Chicago Agreement reflects that both KCSR and IC&E recognize the strategic

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potential of their relationship in promoting north-south traffic flows, and the importance of a competitive alternative to UP dominance in this market.

The Applicants insist that KCSR's request for permanent access to Chicago based on appropriately modified terms of the existing IC&E-KCSR Chicago Agreement is unwarranted because no traffic currently moves pursuant to that agreement, and because IC&E would exercise its rights to terminate the Chicago Agreement if KCSR began to move traffic under its terms. Such arguments miss the point and fail to put in their proper context the KCSR-IC&E relationship, the potential of that relationship, and the role that it can play in providing shippers meaningful transportation alternatives. The existence of the Chicago Agreement is itself indicative of the working relationship between KCSR and IC&E, in which both parties have the opportunity, ability, and incentive to work together to move traffic in the Laredo-Chicago corridor. The proposed Transaction would eliminate this dynamic, KCSR will lose a partner with which it can aggressively pursue NAFTA traffic flows to the mutual benefit of both parties, and shippers will lose a competitive routing alternative.

Based on my understanding of the relationship between KCSR and IC&E, both railroads had come to recognize the imperfections of the existing Chicago Agreement, and, neither party to that agreement has forced the issue either by insisting upon using the agreement or by terminating it preemptively.[24] Rather, the Chicago Agreement has remained in the background,

[24] The fact that neither party has acted unilaterally to cancel the Chicago Agreement reflects the mutual willingness of both sides to use this agreement as a possible platform for mutually advantageous traffic opportunities. The Applicants' dismissive discussion of the Chicago Agreement indicates, on the other hand, that upon CPR's unconditioned control of DME, the stage will be set for CPR to repudiate the Chicago Agreement and terminate any discussions predicated upon the principles and objectives underlying that agreement. Given the success of CPR's [[redacted]] with UP, CPR is far more likely to focus its efforts upon its historical, and larger preferred interchange partner (UP), rather than to undermine the progress

while both companies have explored ways to strengthen their working relationship and the competitive alternative that it provides to shippers. Moreover, I understand that the Chicago Agreement has played a role in KCSR's pricing of interline service with IC&E. For its part, KCSR has proposed ways to modify or replace the Chicago Agreement in a manner satisfactory to both parties, and IC&E had been receptive to such proposals.

Given CPR's close strategic ties to UP, CPR is unlikely to develop an aggressive working cooperation with KCSR to develop attractive alternatives to UP's Laredo-Chicago service, because such efforts would undercut the advantages that CPR enjoys in its partnership with UP. For this reason, CPR has advised KCSR that it is not interested in pursuing any sort of modification to, or substitute for, the Chicago Agreement. In fact, the Application does not make clear what role IC&E's Kansas City-Chicago route would play post-Transaction, although it is easy to conceive of ways that CPR could use this route to leverage more favorable interline terms with UP and to otherwise strengthen its strategic ties with that railroad.

Whatever the case may be – and the Application leaves much room for speculation – CPR clearly does not view the IC&E route from Kansas City-to Chicago as an important part in any NAFTA traffic flows, at least not with KCSR. The Applicants argue against KCSR's Chicago access request by maintaining that competition would not be harmed much by the elimination of the IC&E-KCSR working relationship. To that end, the Applicants try to demonstrate that, quantitatively, KCSR and IC&E do not participate together in very much NAFTA traffic. But the Applicants do not dispute that KCSR and IC&E can offer shippers a meaningful service alternative to UP's single-line service, nor do they contest the potential of an aggressive joint effort by KCSR and IC&E and its possible impact on NAFTA traffic flows.

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that it has made under the [[redacted]] by developing competitive service alternatives with KCSR.

Rather than admit to the prospect that KCSR and IC&E could move beyond the Chicago Agreement to find a better mechanism to compete in north-south traffic flows, the Applicants focus solely upon the Chicago Agreement and NAFTA traffic flows between KCSR and IC&E as they currently are. That, of course, is a very shortsighted and self-serving approach to the issue here, which is the preservation – and indeed strengthening – of competition for NAFTA traffic flows that is very much needed.

Not only have the Applicants denigrated the existing role that KCSR and IC&E play in such flows, but they suggest that, if KCSR is concerned about shipper alternatives to UP's single-line service between Laredo and Chicago, other competitive routes for such traffic will remain even if CPR chooses not to pursue such traffic with KCSR via the Kansas City connection. It is apparent that, in light of CPR's ties to UP, a future CPR-KCSR relationship will not replicate the one that KCSR has had with IC&E, and it is evident that the changes resulting from the proposed Transaction will hurt, not help, competition for traffic moving in the Laredo-Chicago corridor. The Applicants have not rebutted this important point conveyed in KCSR's March 4 Comments.

My traffic analysis as presented in this Rebuttal Verified Statement underscores the need for more effective competition in NAFTA traffic flows. Together, KCSR and an independent IC&E had the ability to enhance such competition, particularly in light of the potential that IC&E's Kansas City-Chicago route offered for KCSR-served shippers. CPR's unconditioned acquisition of DME will not promote competition in NAFTA traffic flows, but instead, because of CPR's relationship with UP, will diminish KCSR's ability to offer a stronger competitive alternative to UP. Rather than acknowledge the potential anticompetitive impact of the Transaction on NAFTA traffic flows, particularly in light of CPR's preference for tendering the vast majority of its NAFTA traffic to UP via the CPR-UP [[redacted]], the Applicants argue that the impact upon competition would be small when viewed in terms of today's traffic situation. An appropriate remedy is necessary to reflect the lost potential of the Chicago Agreement

VERIFICATION

I, George C. Woodward, declare under penalty of perjury that the foregoing statement is true and correct Further, I certify that I am qualified to file this Rebuttal Verified Statement Executed this 19th day of May 2008

George C. Woodward

Grimm

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EXHIBIT C

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REBUTTAL VERIFIED STATEMENT OF CURTIS M. GRIMM

INTRODUCTION

My name is Curtis M. Grimm, and I am Dean's Professor of Supply Chain and Strategy, Robert H. Smith School of Business, University of Maryland at College Park. My qualifications and experience are set forth in the Verified Statement I submitted in this proceeding on March 4, 2008. The purpose of my Rebuttal Verified Statement is to respond to certain issues presented by the Applicants in their "Response to Comments and Requests for Conditions and Rebuttal in Support of Application" ("Reply") as that filing addresses the merits of the conditions that The Kansas City Southern Railway Company ("KCSR") has requested the Surface Transportation Board ("STB") to impose if it were to grant the Application.

My Rebuttal Verified Statement will address two main points in response to the evidence and argument advanced by Applicants[1] in their Reply. First, I will address the BEA ("Business

[1] In this statement, I will use the following acronyms and terms: Canadian Pacific Railway Company ("CP"); Dakota, Minnesota & Eastern Railroad Corporation ("DM&E"); and Iowa,

Economic Area") horizontal analysis initially presented and the critique of that analysis by the Applicants. Second, I will respond to comments about the market structure in the Chicago-Laredo market and discuss the importance of maintaining independent routes in that corridor so as to provide an alternative to UP's dominance of NAFTA traffic to/from Laredo.

I. CANADIAN PACIFIC RAILWAY COMPANY'S ("CP") COMMENTS REFLECT A LACK OF UNDERSTANDING OF MODERN MERGER STRUCTURAL ANALYSIS AND IMPROPERLY PLACE THE BURDEN OF A COMPLETE COMPETITIVE ANALYSIS ON PARTIES OTHER THAN THEMSELVES

In my previous statement, I argued that the STB should adopt a structural approach which evaluates more broadly potential competitive harms from rail mergers, an approach which is commonplace for assessing mergers in other industries and other countries. The first step in such a structural approach is to define relevant markets, for example, rail traffic in origin-destination corridors, for example, using a BEA to BEA corridor as the relevant market for rail transportation. The second step is to analyze market structure prior to the merger as indicated by the market shares of participants in the relevant market. Commonly, a measure of market concentration, such as the share held by the leading firm or firms, or the Herfindahl Index is used. The third step is to analyze the change in market structure in a given market from the merger. If the structure is substantially more concentrated following the merger, there is a strong presumption of competitive harm.

In my previous statement, I pointed out that using the United States Department of Justice's ("DOJ") horizontal merger guidelines as a basis for a structural analysis of the instant transaction reveals horizontal competitive issues which still have not been addressed by the

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Chicago & Eastern Railroad Corporation ("IC&E") (Collectively, CP, DME, & IC&E are "Applicants") I will also refer to DM&E and IC&E, collectively, as "DME," just as was done in the Application.

applicants. I provided an example applying the DOJ structural approach in the Twin Cities (BEA 107) to Chicago (BEA 64) market, where CP competes directly with IC&E and DM&E. The pre-merger Herfindahl is well above the DOJ Guideline threshold of 1800 for a "highly concentrated" market. The post-merger structure, combining the market shares for DME and CP, and again calculating the Herfindahl, shows an increase of more than 100 points. According to the DOJ Guidelines: "Where the post-merger HHI exceeds 1800, it will be presumed that mergers producing an increase in the HHI of more than 100 points are likely to create or enhance market power or facilitate its exercise." Using such an analysis therefore showed that there is at least a presumption of competitive harm in the relevant market. Applicants then have the burden to rebut that presumption.

CP's market analysis did not use such a structural approach, instead relying on a narrow definition of the relevant market (i.e. a particular rail station) and analyzing whether there was actual rail-to-rail competition at that station in a one-year period. Applicants did not analyze whether there was competition in the past or the potential for competition in the future. As such, the evidence is not consistent with modern merger analysis.

Their comments also completely misrepresent the point of my structural approach example. Their view was as follows:

> The shortcomings of Dr. Grimm's "analysis" are legion and include: looking only at a single BEA-pair (Grimm Dep., attached as Appendix S, at 15-19); considering only traffic in one direction *(id* at 31); failing to review data for the study year (2005) designated by the Board *(id* at 24-26); failing to consider, in either his market share or Herfindahl calculations, any mode of transportation other than rail, regardless of the commodity or the length of haul involved *(id.* at 55); failing to consider whether CPR and DME actually served the same shippers in the two BEAs *(id.* at 60-70); and failing to consider evidence that CPR and DME carried different commodities between the two BEAs *(id.* at 71-88).

CP also notes that "the Interstate Commerce Commission ("ICC") and the Board have consistently pointed out the limited usefulness of the Herfindahl Index to analyze railroad consolidations," citing a 1995 ICC decision.

In response, I would like to make the following points. First, the intention of the BEA-BEA horizontal analysis was clearly not to provide an exhaustive study of horizontal competitive effects stemming from this consolidation. The purpose was to illustrate the DOJ structural approach by carrying out the approach in a single relevant market, the Twin Cities to Chicago market.

It is not, and should not be, the burden of the non-merging parties to a rail merger case to carry out a complete competitive analysis and identify all the competitive effects of the merger. The burden is on the Applicants to provide a comprehensive analysis of the merger. A complete competitive analysis should entail the Applicants extending what I did in the Twin Cities to Chicago market to ALL BEA to BEA origin-destination pairs where the two merging railroads compete. This would include the Chicago to Twin Cities market (the reverse direction of the one I examined), but it would not be appropriate to combine the data from the two directions. The two directions of a BEA pair should clearly be treated as distinct markets. Once such a BEA to BEA analysis for all markets was undertaken, then the Applicants should review that analysis, make a determination of which corridors might present a presumption of competitive harm, and then, using some of the factors noted by Applicants in criticizing my Twin Cities to Chicago example - such as the existence of intermodal competition - to rebut any presumption of competitive harm. Applicants have not presented such an analysis.

I would also like to underscore the logic for using rail as the relevant market in the preliminary analysis. I have consistently argued that rail is the appropriate product market, and that one should reject a market definition that includes other modes within the product market when doing the initial BEA to BEA analysis. Although truck competition can supplement inadequate intramodal competition for some products and markets, it is not an effective substitute for rail to rail competition. The relative costs of truck and rail, and thus the extent to which motor carriers are competitive with rail in a particular market, depend on the commodity being transported, the distance between origin and destination, and other factors. Given that railroads set prices to a large degree individually on a movement-by-movement basis, the fact that some shippers may have truck alternatives to rail for some movements does not help other shippers for their movements where no competitive alternatives exist. Intermodal competition should only be a factor to consider in rebutting whether or not a given BEA to BEA market produces a presumption of competitive harm.

The definition of a BEA origin-destination pair as the proper geographic market is based on the fact that railroads can and do provide effective competition with each other when they do not physically serve the same shipper. As discussed in my previous statement and at great length in previous writings and merger filings before the ICC and STB, the point is that CP and DME do indeed compete with each other in the Twin Cities to Chicago corridor even where they may not physically serve the same shippers and carry precisely the same commodities. For example, shippers can use trucks to transload or access alternative railroads within the same geographic areas. This is a common practice for grain shipments, where trucks are used to carry grain to alternative consolidation points located along rail lines. Shippers may have warehouses located on alternative rail lines in the region, or may be able to access public warehouses on a rival railroad. Shippers can build out, or threaten to build out, or can relocate plants. Shippers can substitute a product received on an alternative rail line. Shippers may be able to obtain reciprocal switching to gain access to the railroads in the BEA or use terminal railroads to interchange among all carriers serving the BEA. All of these possibilities provided by independent rail options in the region provide shippers leverage when they negotiate with railroads, and thus provide competitive pressures for lower rates. Applicants failed to consider any of these possibilities in their very narrow, station specific examples.

Let me make clear the point of my initial example of a structural analysis, and where the burden should be to fully investigate competitive harms. My structural analysis, following standard DOJ procedures, creates a presumption of a competitive harm, as noted in the above quote from the merger guidelines. Other information can and should be considered when the initial analysis creates a presumption of competitive harm, including commodities and intermodal options, before a final decision is reached on the competitive effects of the merger. But the burden clearly should be on the applicants to do a complete structural analysis in all markets, and, if a presumption of competitive harm is reached from this analysis, as in the Twin Cities-Chicago market, the burden should be on the applicants, not other parties, to provide additional information if the initial presumption is to be erased.

The final point in the CP critique is that based on a 1995 ICC merger decision, Herfindahl measures of concentration and modern structural analysis of merger competitive effects have not been the norm for the ICC and STB. I would argue, as I pointed out in my initial statement, that the railroad industry has changed significantly since 1995, and the STB needs to seriously consider corresponding changes in its merger analysis. The railroad industry is now very highly concentrated following the merger wave of the mid to late 1990s; moreover, railroads are beginning to achieve strong levels of profitability and some have been declared revenue adequate for the first time in a long time. As a result, some believe that the STB has not been thorough enough in evaluating horizontal effects of rail mergers, and that Congress should shift merger authority to DOJ to remedy this problem.

In this context, it is important to note that the DOJ follows a structural approach, well grounded in industrial organization economics, which entails defining markets and evaluating changes in concentration from the merger; much in the same way as I suggest should have been done here and has been done by other applicants in other merger proceedings before the Board. Furthermore, DOJ's threshold of competitive concern regarding changes in concentration is significantly different than that of the ICC or the STB. Indeed, within the U.S., the structural approach is followed not only by DOJ, but by the Federal Trade Commission ("FTC"), and regulatory agencies which focus on merger analysis within given industries, such as the Federal Communications Commission ("FCC") and the U.S. Securities and Exchange Commission ("SEC"). It is difficult to come up with an example, within or outside the U.S., of a regulatory agency assessing mergers with any approach other than a structural one. There is good reason for this; the approach is based on sound principles, the Structure-Conduct-Performance paradigm from industrial organization economics, which dates back more than 50 years. Here, Applicants did not provide such a structural analysis.

I would suggest that the STB could avoid significant criticism of its merger analysis approach if it were to require merger applicants to provide a structural analysis consistent with that used by other agencies and DOJ. In doing so, the STB should require applicants to provide a more complete horizontal analysis than was done here. Alternatively, the Board may need to consider supplementing the record with their own competitive analysis, as does DOJ. It would be better for the STB to retain merger authority, as the STB has significant industry expertise on rail, and broad conditioning powers, than to allow its merger analysis approach to be used as the excuse for removing merger authority. Moreover, consistent with the spirit of the STB's new rail merger guidelines, a more comprehensive structural approach is needed.[2]

II. CP'S COMMENTS TOTALLY MISREPRESENT THE COMPETITIVE MARKET STRUCTURE IN THE CHICAGO-LAREDO MARKET

A second area of the CP filing concerns the market structure of the Chicago-Laredo corridor. In this regard as well, the CP filing failed to adequately analyze, using basic industrial organization economics principles and determinants of market structure in the railroad industry, the adverse impacts of the Transaction in the Chicago-Laredo market. The view of CP is that there is ample competition in the Chicago-Laredo corridor, and therefore no need to preserve the competitive option provided by the KCSR rights to Chicago over the IC&E. CP bases its conclusion solely on the number of physical routings available in that corridor: "NAFTA traffic that could potentially move via a Chicago-Laredo route actually moved in 2005 over a total of 32 different single line and interline rail routes." (CPR-14 at 36). Indeed, during my deposition, attorneys for CP engaged in a laborious exercise of delineating, with a railroad map, all of the various railroad routings for Chicago-Mexico traffic (Grimm deposition, pp. 137-144).

Initially, I would like to note that the CP statements regarding the number of rail routings goes beyond the Chicago-Laredo corridor and includes other Mexican gateways. The ICC and STB have long recognized the premiere position of Laredo as a Mexico gateway, based on many factors; more efficient routings, strong infrastructure support, and the pressure of customs and ancillary services. Union Pacific/Southern Pacific Merger, 1 S.T.B. 233, 421-426 (1996). More

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[2] As I have not done a complete structural analysis of the competitive effects of this Transaction, nor have the Applicants, I cannot conclude that the Transaction as a whole will result in a substantial lessening of competition, although I can reach such a conclusion with respect to the Chicago to Laredo market. My point is that the Applicants have the burden to present such a structural analysis for all markets, and having failed to do so, the Board cannot, without doing its own analysis, reach a conclusion, as required by 49 U.S.C. 11324, that the Transaction will not result in a substantial lessening of competition.

importantly, CP's litany of other routings ignores whether these "alternative" routings are truly independent routings, i.e. whether they actually compete against each other.

It has long been a basic tenet of rail competitive analysis that competition is greatly enhanced when alternative, fully-independent routings are available. If one firm participates on all routings, competition can be greatly hampered. This view, that independence of routings is critical, was clearly stated many years ago by the ICC:

> Competition between railroads generally requires the presence of two or more independent routes, that is, routes having no carriers in common. When a single carrier is a necessary participant in all available routes, i.e. a bottleneck carrier, it can usually control the overall rate sufficiently to preclude effective competition.

Consolidated Papers, Inc., et al v. Chicago and North Western Transportation Co., et al, 7 , I.C.C. 2d 330, 338 (1991). Most importantly, CP does not apply the basic principles of market structure – that one must examine MARKET SHARE of the participants in the market to assess the market structure and therefore the need for preservation of the KCSR/IC&E competitive alternative. Nor has CP considered that UP appears in almost every single one of the so-called "alternative routes" analyzed by the Applicants.

To provide data on market share and market concentration, I analyzed the railroad traffic between Laredo, TX and Chicago from the STB's 2005 Waybill Sample. For traffic from Laredo to Chicago (Table 1), I used all traffic which showed either Laredo either as the origin or a junction point and was destined to BEA 64 (Chicago-Gary-Kenosha, IL-IN-WI) or showed Chicago as the junction point. For traffic from Chicago to Laredo (Table 2), I used all traffic to Laredo which showed BEA 64 as the origin or a junction point. First, the data in Tables 1 and 2 clearly reveal that there are only two independent alternatives in this market, UP and KCSR. Second, the market share data present a powerful picture of UP dominance in this market, and underscores the need for preservation and strengthening of the KCSR-IC&E competitive option.

Based on the 2005 waybill data, UP has a revenue market share from Laredo to Chicago of over [redacted] From Chicago to Laredo, UP's revenue market share is also over [redacted]. DOJ's threshold for monopolization is generally in the range of a single firm holding 70% or more of the market. By any standard, UP monopolizes the rail market in both directions between Chicago and Laredo. Although the KCSR-IC&E routing does not have a large market share and is dwarfed by UP's dominance, the KCSR-IC&E routing is nonetheless important in maintaining an alternative to UP's dominance in that corridor. The STB has long recognized the need to maintain a competitive balance to UP for NAFTA traffic flows, and provided Tex Mex trackage rights in the UP/SP proceeding so as to connect with KCSR in an effort to provide independent alternatives to the UP monopoly. The STB should continue its efforts to preserve and strengthen competitive alternatives to UP in the Chicago-Laredo corridor and should not approve the Transaction without at least ensuring that KCSR's ability to compete in this corridor remains.

VERIFICATION

I, Curtis M. Grimm, declare under penalty of perjury that the foregoing statement is true and correct. Further, I certify that I am qualified to file this Rebuttal Verified Statement.

Executed this 19th day of May, 2008

Curt Grimm

Curtis M. Grimm

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Table 1: 2005 Railroad Traffic

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Table 2: 2005 Railroad Traffic

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